Subject directory for this article begins on page 489.

N. ELECTION YEAR ISSUES

by
Judith E. Kindell and John F. Reilly

1. Introduction

In a presidential election year, questions frequently arise regarding the interplay of political campaign activities and exemption from federal income tax. This article addresses many of these questions in three areas: the prohibition on political campaign activities of IRC 501(c)(3) organizations, the taxation of political organizations under IRC 527, and the political campaign activities of IRC 501(c) organizations other than those described in IRC 501(c)(3).

This article employs a question and answer format. A word of warning, though -- many questions, particularly respecting IRC 501(c)(3) organizations and the political campaign prohibition, do not admit of a bright-line answer. In these areas, the facts and circumstances of a particular situation will control; therefore, some "answers" will instead consist of a description of the factors to be evaluated in reaching a determination.

2. IRC 501(c)(3) Organizations and the Political Campaign Prohibition

A. History of the Statutes

A detailed history of the legislation regarding political campaign activities of IRC 501(c)(3) organizations has yet to be written. The history, while in some respects murky, is not long -- prior to 1954, there was no legislation.[1]

[1] The political campaign prohibition does have a vague and unenacted antecedent. What eventually became the Revenue Act of 1934, under which the lobbying restriction of IRC 501(c)(3) was first enacted, at one time contained a provision extending the prohibition to "participation in partisan politics." S. Rep. No. 73-558, 73d Cong., 2d Sess. 26 (1934). The provision, however, was deleted in conference, so that only the lobbying restriction remained. H.R. Conf. Rep. No. 73-1385, 73d Cong., 2d Sess. 3-4 (1934). In explaining its deletion, Representative Samuel B. Hill stated: "We were afraid this provision was too broad." 78 Cong. Rec. 7,831 (1934).

During Senate consideration of what became the Revenue Act of 1954, Lyndon Johnson, then Senate Minority Leader, added a floor amendment to provide that IRC 501(c)(3) organizations may not "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." The amendment was accepted; no debate or discussion took place. 100 Cong. Rec. 9,604 (1954). The Conference Report (H.R. Conf. Rep. No. 83-2543, 83d Cong., 2d Sess. (1954)) contains no further discussion of the amendment.

In 1969, a number of provisions were enacted concerning the treatment of private foundations. Under one provision, an initial tax in an amount equal to 10% of each taxable expenditure and an additional 100% tax on each taxable expenditure previously taxed and not corrected within the taxable period is imposed on the private foundation. In addition, taxes are imposed on foundation managers who agreed to the making of the taxable expenditure. IRC 4945. A taxable expenditure includes any amount paid or incurred by a private foundation to influence the outcome of any specific public election or to directly or indirectly carry on any voter registration drives, unless certain requirements are met. IRC 4945(d)(2). Thus, due to the Tax Reform Act of 1969, a private foundation that participates in a political campaign not only risks losing its exemption, it also is subject to tax on the amounts it expends for such participation. Taxes on private foundation expenditures to influence the outcome of any specific public election or to carry on voter registration drives did not seem likely when the House Committee on Ways and Means began its hearings on private foundation activities -- the Chairman's press release, which outlined the hearings' agenda, made no mention of this kind of activity. Tax Reform 1969: Hearings Before the House Comm. on Ways and Means, 91st Cong., 1st Sess. 3-11 (1969) (press release of Chairman Wilbur D. Mills). However, testimony given almost at the outset of the hearings raised the specter of private foundation involvement in the electoral process. First, in a rather scathing manner, an incumbent congressman testified that a private foundation had been used against him in a primary election. Id. at 213-237 (statement and testimony of Representative John J. Rooney).[2] Soon

[2] Subsequent to Representative Rooney's testimony, his primary opponent (and, oddly enough, eventual successor in Congress) appeared before the committee and denied all of Rooney's allegations. Id. at 1036-1056 (statement and testimony of Frederick W. Richmond). Wherever the truth lay, however, was not critical -- Rooney's words, ". . . this political gimmick is a threat to every officeholder, in Congress or elsewhere, who does not have access to a fat bankroll or to a business or to a private foundation" (id. at 213), spoke to what could happen, whether or not it actually occurred in the particular case. The potential effect

thereafter, the President of the Ford Foundation became embroiled in a lengthy and often acrimonious discussion with various Committee members over both the Foundation's involvement in an extremely controversial school decentralization experiment in Brooklyn that included an election and the Foundation's financing of voter registration drives in Cleveland before the election of Mayor Carl B. Stokes. Id. at 354-431 (statement and testimony of McGeorge Bundy). To a considerable extent, those incidents seem to have impelled enactment of IRC 4945(d)(2).

In 1987, Congress again amended the law applicable to charitable organizations, this time specifically focusing on the prohibition on political campaign activity. Congressional concern appears to have been triggered by two occurrences. First, in 1986, an organization then exempt under IRC 501(c)(3), the National Endowment for the Preservation of Liberty, was reported to have intervened in Congressional campaigns, opposing the reelection of members who had not supported aid to the Nicaraguan Contras. Second, questions had been raised about the use of ostensibly educational IRC 501(c)(3) organizations by politicians to promote their candidacy or potential candidacy. After hearings held by the Subcommittee on Oversight of the Committee on Ways and Means and after the Subcommittee made its recommendations, IRC 501(c)(3) was amended to clarify that the prohibition on political campaign activity applied to activities in opposition to, as well as on behalf of, any candidate for public office, in accordance with the existing interpretation of the prohibition in the regulations. Congress also amended IRC 504 to provide that an IRC 501(c)(3) organization that lost its exemption due to violating the prohibition on political campaign activities may not at any time thereafter be treated as an IRC 501(c)(4) organization. (Previous to the amendment, IRC 504 had applied only to IRC 501(c)(3) organizations that lost their exemption due to substantial lobbying activities.)

In addition to these amendments, Congress enacted several new provisions in 1987 concerning the political campaign prohibition for IRC 501(c)(3) organizations. The first of these was IRC 4955, which imposes taxes on the political expenditures of IRC 501(c)(3) organiza-tions; its tax/correction structure and the rates imposed are identical to IRC 4945. (To avoid duplication of excise taxes on a political expenditure made by a

---

of Rooney's testimony was made manifest when the columnist Kenneth R. Crawford devoted an entire article to the matter, predicting correctly that "[t]he tax reform bill almost certainly will impose tighter restrictions on tax-exempt foundations, especially against political activity." The Rooney Reform, Newsweek, March 3, 1969, at 29.

private foundation, IRC 4955 provides that if its taxes are imposed on a private foundation, the expenditure is not treated as a taxable expenditure under the IRC 4945 tax. IRC 4955(e).) As set forth in the legislative history, Congress enacted IRC 4955 because it believed that the absence of any stricture other than revocation for violation of the prohibition on political campaign activity created two problems. One was that the penalty of revocation was disproportionate to the violation in cases where the expenditure was small, the violation was unintentional, and the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future. The other was that, in some cases, revocation would be an ineffective remedy, particularly if the IRC 501(c)(3) organization ceased operations after it diverted all of its assets to improper purposes. Therefore, IRC 4955 applies to IRC 501(c)(3) organizations whether or not their tax-exempt status is revoked. Congress specifically noted that the enactment of IRC 4955 did not change the prohibition on political campaign activities of IRC 501(c)(3) organizations; it looked upon the provision fundamentally as an additional deterrent. In addition, because Congress was concerned that some candidates were using IRC 501(c)(3) organizations to promote their candidacy, it provided that, for purposes of IRC 4955, political expenditures of IRC 501(c)(3) organizations include certain expenses of candidate-controlled organizations. H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1623-1627 (1987).

Congress also found that existing audit and enforcement procedures were not sufficient to deter an IRC 501(c)(3) organization from willfully and flagrantly violating the political campaign prohibition. Therefore, it enacted IRC 6852 and IRC 7409. IRC 6852 provides that if such a violation occurs, the Service may immediately determine the amount of income and IRC 4955 tax due from the IRC 501(c)(3) organization, both for that year and the immediately preceding tax year. The tax shall be immediately due and payable. Therefore, the Service will immediately assess the tax so determined and demand payment from the organization. (The determination and assessment of the tax under IRC 6852 terminates the taxable year of the IRC 501(c)(3) organization.) IRC 7409 grants authority to the Service to seek an injunction against an IRC 501(c)(3) organization that flagrantly violates the political campaign prohibition to prevent further political expenditures by the organization. An injunction may be sought only if three conditions are met:

(A) The organization has been notified that the Service intends to seek an injunction if the making of political expenditures does not immediately cease;

(B) The Commissioner has personally determined that the organization has flagrantly violated the political campaign activity prohibition; and

(C) The Commissioner has personally determined that injunctive relief is appropriate to prevent future political expenditures.

B. Definition of Terms

1. What is a "candidate?"

A candidate for public office is any individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state, or local. Reg. 1.501(c)(3)-1(c)(3)(iii) and Reg. 53.4945-3(a)(2). Since a candidate must be a contestant for elective public office, IRC 501(c)(3) organizations are prohibited from participating or intervening in election campaigns only. Thus, an IRC 501(c)(3) organization is not prohibited from attempting to influence the Senate confirmation of an individual nominated by the President to serve as federal judge since federal judges are not elected. Notice 88-76, 1988-2 C.B. 392.

2. What is a "public office?"

Neither the IRC 501(c)(3) nor the IRC 4945 regulations define the term "public office." Nevertheless, there are criteria available, all of which proceed from the obvious principle that the term "public office" requires that there be some statutory or constitutional basis for construing the office as "public." For example, guidance on the issue of whether an office or position in a political party is a public office for purposes of the IRC 501(c)(3) political campaign prohibition is found in G.C.M. 39811 (June 30, 1989). The particular position at issue in the G.C.M. was that of precinct committeeman. The position possessed the following characteristics of a public office under state law: it was (1) created by statute; (2) continuing; (3) not occasional or contractual; and it (4) had a fixed term of office; and (5) required an oath of office. G.C.M. 39811 concludes that,

under the relevant state law, the position of precinct committeeman was a public office within the meaning of IRC 501(c)(3). The factors listed in the G.C.M. should be taken into consideration in determining whether elections for political party positions are elections for public office.

Additional guidance may be obtained from a definition in the private foundation excise tax regulations, Reg. 53.4946-1(g)(2)(i). However, since Reg. 53.4946-1(g)(2)(i) defines public office for a different, and more limited, purpose, it should be used with great care, particularly where elections for offices or positions in a political party are concerned. The extent of the applicability of Reg. 53.4946-1(g)(2)(i) is discussed in the following question and answer.

3. Should the term "public office" be construed solely by reference to the definition of "public office" set forth in Reg. 53.4946-1(g)(2)(i)?

When Congress enacted IRC 4941 to impose tax on acts of self-dealing between private foundations and disqualified persons, it specifically wished to include "government officials at policymaking levels" within the self-dealing orbit. Staff of the Joint Committee on Internal Revenue Taxation for use of the Senate Committee on Finance, 91st Cong., 1st Sess., Summary of H.R. 13270 (Tax Reform Act of 1969) 3 (Comm. Print 1969).

Reg. 53.4946-1(g)(2)(i) defines "public office" in order to explicate a species of "government official" that is considered a "disqualified person" for purposes of the tax; namely, persons described in IRC 4946(c)(5) as holders of an elective or appointive public office in the executive, legislative, or judicial branch of the government of a State, possession of the United States, or political subdivision or other area of any of the foregoing, or the District of Columbia, that pays gross compensation at an annual rate of $15,000 or more. In its definition, Reg. 53.4946-1(g)(2)(i) follows expressed legislative intent and places great stress on the independent performance of policy-making functions:

> In defining the term "public office" . . . such term must be distin-guished from mere public employment. Although holding a public office is one form of public employment, not every position in the employ of a State or other governmental subdivision . . . constitutes "public office." Although a determination whether a public employee holds a public office depends

> on the facts and circumstances of the case, the essential element is whether a significant part of the activities of a public employee is the independent performance of policy-making functions. . . . [S]everal factors may be considered as indications that a position in the executive, legislative, or judicial branch of the government of a State, . . . or political subdivision or other area of the foregoing . . . constitutes a "public office." Among such factors to be considered in addition to that set forth above, are that the office is created by the Congress, a State constitution, or the State legislature . . . and the powers conferred on the office and the duties to be discharged by such office are defined either directly or indirectly by the Congress, State constitution, or State legislature, or through legislative authority.

The "independent performance of policy-making functions"/"mere public employment" dichotomy does not help one resolve the issue of whether an office or position in a political party is a "public office" for purposes of the prohibition on participation or intervention in a political campaign under IRC 501(c)(3). Political party officials do not engage in "the independent performance of policy-making functions," but they play a significant role in the electoral process. Consequently, other facts and circumstances, such as those set forth in the remainder of the regulation and those set forth in G.C.M. 39811, must be brought to bear on the issue.

Insofar as determining whether an executive, legislative, and judicial election involves a "public office" for purposes of IRC 501(c)(3), Reg. 53.4946-1(g)(2)(i) has greater relevance. Facts and circumstances prevail, there must be some governmental indication that the office is a public office, the officeholder must be more than a mere employee -- these are principles underlying Reg. 53.4946-1(g)(2)(i) and a determination under IRC 501(c)(3) must be consistent with those principles. (Similarly, Reg. 1.527-2(d), in discussing whether a federal, state, or local executive, legislative, or judicial office is a public office for purposes of IRC 527, provides both that the facts and circumstances of each case will be determinative and that "principles consistent" with those found under Reg. 53.4946-1(g)(2) will be applied.) Even here, however, caution is advised. One must not overemphasize "the independent performance of policy-making functions" to decide that an elective office is not a public

office simply on the basis that the office's independent policy-making functions are too insignificant.[3]

Accordingly, insofar as determining under IRC 501(c)(3) whether an election is an election for a "public office," while Reg. 53.4946-1(g)(2)(i) provides some guidance, particularly where legislative, executive, and judicial offices are concerned, it should neither be read too literally nor be considered solely determinative. Rather, all the facts and circumstances of a particular case must be considered to resolve the issue.

4. What is the meaning of "offers himself, or is proposed by others?"

Individuals who have publicly announced their intention to seek election to public office have clearly offered themselves as contestants for the office and are candidates within the meaning of IRC 501(c)(3). However, an individual who has not yet announced an intention to seek election to public office may nevertheless be considered to have offered himself or herself as a contestant for the office. See TAM 91-30-008 (April 16, 1991) for a situation where an unannounced candidate's campaign committee published material regarding his record and mentioned his "prospective candidacy." The determination of when an individual has taken sufficient steps prior to announcing an intention to seek election, so that he or she may be considered to have offered himself or herself as a contestant for the office is based on the facts and circumstances.

Similarly, others may propose an individual as a contestant for a public office, even when the individual has announced an intention of not seeking election to the office. For example, in the 1992 New Hampshire Democratic Presidential Primary, there was a well publicized Draft Cuomo Committee that was urging voters to elect Mario Cuomo as a write-in candidate. Despite the fact that Governor Cuomo had indicated that he was not running for President, he was a candidate within the meaning of IRC 501(c)(3)

[3] The story of "Hymie's ferryboat" bears repeating here. Hymie Schorenstein, who was Brooklyn's district leader in the 1920's, had to deal with a complaint by one of his almost innumerable candidates that too much attention was being paid to the top of the ticket (Governor Franklin D. Roosevelt or, in an alternative version, Mayor James J. Walker). Mr. Schorenstein responded by talking about ferryboats: "When that big ferry from Staten Island sails into the ferry slip, it never comes in strictly alone. It drags in all the [garbage] from the harbor behind it. Roosevelt [or Walker] is our Staten Island ferry." It is not known, and certainly not to be presumed, that all of Mr. Schorenstein's candidates were running for offices that involved "the independent performance of policy-making functions" as the drafters of the self-dealing statutory and regulatory provisions understood it. See William Safire, Safire's Political Dictionary 317-318 (1978).

because he was proposed as a contestant for the office of President by others. See Kevin Sack, Cuomo Tells Presidential Draft Group to End Campaign, N.Y. Times, Feb. 22, 1992, at A8; James M. Perry, A Cadre of Supporters Is Refusing To Write Off Cuomo as a Candidate, Wall St. J., Feb. 12, 1992, at A22. Therefore, in that situation, an IRC 501(c)(3) organization could not have supported or opposed Governor Cuomo as a candidate for President without violating the prohibition on political campaign activity. On the other hand, as the staff of the Joint Com-mittee on Taxation noted, in a background paper prepared for the 1987 hearings, ". . . the fact that an individual is a prominent political figure does not make him a candidate, even if there is speculation regarding his possible future candidacy for particular offices." Staff of the Joint Committee on Taxation, 100th Cong. 1st Sess., Lobbying and Political Activities of Tax-exempt Organizations 14 (Joint Comm. Print 1987). In other words, some action must be taken to make one a candidate, but the action need not be taken by the candidate or require his consent.

Even if no other person or organization proposes an individual as a contestant for an elective public office, an IRC 501(c)(3) organization may not support the individual in an election for public office without violating the political campaign prohibition. By supporting a contestant for an elective public office, the IRC 501(c)(3) organization is proposing the individual as a "candidate" for the purposes of IRC 501(c)(3).

5. Can Federal Election Commission (FEC) or Federal Communications Commission (FCC) rules be used to define "candidate" for IRC 501(c)(3) purposes?

In a word, no. The FEC and FCC statutes and regulations were drafted for different purposes, and their treatments of who is a candidate do not embrace (in fact, are antithetical to) the "offers himself, or is proposed by others" formulation of Reg. 1.501(c)(3)-1(c)(3)(iii) and Reg. 53.4945-3(a)(2).

With respect to the FEC, its principal purpose appears to be to find where a candidate's money came from, to know the amount of money contributed, and to have this information disclosed contemporaneously to the Commission. Therefore, the FEC regulations provide that an individual becomes a candidate for federal office when the individual, or another person to whom such individual has given his or her consent, has received

contributions or made expenditures aggregating in excess of $5,000. 11 C.F.R. sec. 100.3(a). Assuming that Governor Cuomo did not give his consent to the Draft Cuomo Committee, he would not have been a candidate under the FEC regulations.[4] Similarly, an individual who does not accept contributions would not be considered a candidate for FEC purposes, but would be considered a candidate under IRC 501(c)(3). Thus, when William Proxmire did not accept contributions in his last Senatorial election campaign, he was not a candidate for FEC purposes, but an IRC 501(c)(3) organization nevertheless would have been prohibited from supporting or opposing him because he was a candidate under IRC 501(c)(3).[5]

As to the FCC, it appears that the primary purpose of its regulations is to assure that all declared candidates (and only declared candidates) have equal access to broadcasting. Consequently, its regulations define a "legally qualified candidate" as any person who (1) has publicly announced his or her intention to run for nomination for office, (2) is qualified under the applicable law to hold the office, and (3) meets one of three alternative tests concerning elections and primaries, nominations by convention or caucus, and nominations for the offices of president and vice president. 47 C.F.R. secs. 73.1940(a)(1), 76.5(g)(1). It follows, therefore, that the FCC regulations have a purpose opposite to the Treasury regulations; while the FCC's regulations are somewhat exclusive, Treasury's are rather inclusive.

To summarize, while rules of other agencies, particularly the FEC, may be helpful in elucidating some aspects of the IRC's treatment of political campaign activities, the FEC and FCC definitions relating to who is a candidate are of limited value in determining who is a candidate for IRC purposes.

---

[4] The 1964 New Hampshire Republican primary offers a more graphic illustration. Two individuals, Paul Goldberg and David Grindle, disappointed with the two principal Republican contenders, Senator Barry Goldwater and Governor Nelson Rockefeller, decided to run Henry Cabot Lodge for the Republican nomination. There was only one problem: Mr. Lodge, who was serving as Ambassador to South Vietnam, did not give his consent to the campaign. It was not much of a problem, however: New Hampshire required no candidate authorization; in fact, anyone could file as a Lodge candidate and there was nothing Ambassador Lodge could do to stop it. Ambassador Lodge, or more precisely Ambassador Lodge's campaign (since he was not part of it), won the primary. See Charles Brereton, First in the Nation: New Hampshire and the Premier Presidential Primary 35-51 (1987).

[5] Senator Proxmire spent $697 in his 1976 campaign. Michael Barone et al., The Almanac of American Politics 1978 918 (1977). Former Senator Proxmire is an unusual example on the national scene (although not a unique one -- current Representative William Natcher often has failed to cross the $5,000 threshold in the 10 campaigns he has conducted since the FEC was established); however, many local and some state elections involve candidates who conduct campaigns without either collecting or spending $5,000.

6. What is meant by "does not participate in, or intervene in (including the publishing and distributing of statements)?"

The regulations provide that activities that constitute participation or intervention in a political campaign include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to a candidate for public office. Reg. 1.501(c)(3)-1(c)(3)(iii). See also Reg. 53.4945-3(a)(2). Consequently, a written or oral endorsement of a candidate is strictly forbidden. The rating of candidates, even on a non-partisan basis, also is prohibited. See Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied 490 U.S. 1030 (1989), discussed below. Similarly, an IRC 501(c)(3) organization may not distribute partisan campaign literature, provide or solicit financial or other forms of support to or for candidates or political organizations, or establish political action committees (PACs). In situations where there is no explicit endorsement or partisan activity, there is no bright-line test for determining if the IRC 501(c)(3) organization participated or intervened in a political campaign. Instead, all the facts and circumstances must be considered. Some of the facts and circumstances to be considered in specific situations are discussed below.

7. How does advocacy of an issue relate to the concept of participation or intervention in a political campaign?

This question was presented in the following form at the meeting of the Exempt Organi-zations Committee of the ABA Tax Section, held on February 4, 1992:

"Many charitable organizations conduct mass media advocacy on issues such as abortion rights, the environment, crime, defense spending, health care and tax reform, during non-election periods. If certain candidates become identified with positions on these issues during a campaign, must the organization alter its advocacy in order to avoid the IRC 501(c)(3) electioneering prohibition? Can the charity use the opportunity of the campaign to gain greater attention from candidates and the public, to its issues? Suppose a pro-life political group, during a campaign, heavily attacks pro-choice positions in TV ads, implying criticism of pro-choice incumbents. Can a pro-choice charity pay for TV ads to respond solely on the issues, using free air time provided by the TV station?"

No situation better illustrates the principle that all the facts and circumstances must be considered than the problem of when issue advocacy becomes participation or intervention in a political campaign. On the one hand, the Service is not going to tell IRC 501(c)(3) organizations that they cannot talk about issues of morality or of social or economic problems at particular times of the year, simply because there is a campaign occurring. On the other hand, the Service is aware that an IRC 501(c)(3) organization may avail itself of the opportunity to intervene in a political campaign in a rather surreptitious manner. The concern is that an IRC 501(c)(3) organization may support or oppose a particular candidate in a political campaign without specifically naming the candidate by using code words to substitute for the candidate's name in its messages, such as "conservative," "liberal," "pro-life," "pro-choice," "anti-choice," "Republican," "Democrat," etc., coupled with a discussion of the candidacy or the election. When this occurs, it is quite evident what is happening -- an intervention is taking place. See TAM 91-17-001 (Sept. 5, 1990) for an example of coded language constituting political campaign intervention.[6]

Therefore, the fundamental test that the Service uses to decide whether an IRC 501(c)(3) organization has engaged in political campaign intervention while advocating an issue is whether support for or opposition to a candidate is mentioned or indicated by a particular label used as a stand-in for a candidate.

[6] A finding of political campaign intervention from the use of coded words is consistent with the concept of "candidate" -- the words are not tantamount to advocating support for or opposition to an entire political party, such as "Republican," or a vague and unidentifiably large group of candidates, such as "conservative" because the sender of the message does not intend the recipient to interpret them that way. Code words, in this context, are used with the intent of conjuring favorable or unfavorable images -- they have pejorative or commendatory connotations. When combined with discussions of elections, the code words also make specific candidates identifiable -- the organization would not use up air time or newspaper space with a code word if the word was not intended to communicate to the viewer, listener, or reader a specific elective choice. The voter in Vermont, hearing an exhortation regarding "liberal" candidates, may not know who fits that label in Kansas, but presumably he knows who stands for what in Vermont, which is why the code word is used in the first place.

8. Is it feasible for the Service to adopt the FEC "express advocacy" standard to more expressly delimit the concept of participation or intervention in a political campaign?

No, it is not feasible for the Service to adopt the FEC "express advocacy" standard to determine when participation or intervention in a political campaign on behalf of or in opposition to a candidate for public office has occurred.

The FEC's "express advocacy" standard came into being because the Supreme Court held a provision of the Federal Elections Campaign Act (FECA) relating to contributions "to reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate." Buckley v. Valeo, 424 U.S. 1, 77 (1976). FECA was subsequently amended to conform to the "express advocacy" requirement of Buckley. 2 U.S.C. secs. 431(e)(1), 431(f)(1), 434(e).

The FEC regulations define "expressly advocating" as unambiguously advocating the election or defeat of a clearly identified candidate. 11 C.F.R. sec. 109.1(b)(2). Examples (taken directly from Buckley) include "vote for," "elect," and "Smith for Congress" or "vote against," "defeat," and "reject." Essentially, therefore, the issues under "express advocacy" are whether there is a clearly identified candidate and whether there is a message that would be unambiguously construed as urging someone to vote for or against that candidate. Since the message must be unambiguous, where purported political campaign intervention is coupled with an issue, any doubts are resolved in the issue's favor. Orloski v. Federal Election Commission, 795 F.2d 156 (D.C. Cir. 1986), furnishes an example. Orloski concerned corporate contributions to a picnic held immediately before an election by a "Senior Citizens Advisory Committee" established years before by the incumbent congressional candidate. Campaign posters were placed throughout the park, although not in the picnic area. Members of the candidate's staff planned and attended the picnic; they distributed information on social security, as well as a "senior citizen's report" bearing the candidate's name. No express advocacy of the election of the candidate or the defeat of his opponent took place at the event, however; nor was there any solicitation of contributions. Under these circumstances, the court upheld the FEC's determination that the event was "nonpolitical," the picnic's purpose was other than to influence a federal election, and the corporate donations were not contributions.

Under the "express advocacy" standard, the decisions of the FEC and the court hardly could have been otherwise. What would be our decision, however, if an IRC 501(c)(3) organization, rather than a corporation, had financed the picnic? The language of IRC 501(c)(3) indicates a much broader scope to the concept of participation or intervention in a political campaign. The statute clearly states that participation or intervention in a political campaign includes publication or distribution of statements, which denotes that prohibited political campaign activity is not to be limited to statements. It would do violence to the statute, not to mention close to 40 years of interpretation, to adopt the "express advocacy" standard. Therefore, the "express advocacy" standard may not be adopted for purposes of the political campaign prohibition of IRC 501(c)(3).

9. How do the rules relating to IRC 501(c)(3) educational activity interplay with the political campaign prohibition? Does satisfaction of the methodology test of Rev. Proc. 86-43 insulate an activity of an IRC 501(c)(3) organization from being characterized as having engaged in a prohibited political campaign participation or intervention?

The most common question that arises in determining whether an IRC 501(c)(3) organization has violated the political campaign prohibition is whether the activities constitute political intervention or whether they are educational, one of the purposes for which an IRC 501(c)(3) organization may be formed. Sometimes, however, the answer is that the activity is both -- it is educational, but it also constitutes intervention in a political campaign.

"Educational" is defined for IRC 501(c)(3) purposes as including instruction of the public on subjects useful to the individual and beneficial to the community. While an educational organization may advocate a particular viewpoint, it is not educational if its principal function is the mere presentation of unsupported opinion. Examples of educational organizations include organizations whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs, which may be on radio or television. Reg. 1.501(c)(3)-1(d)(3). One step in determining whether an activity of an IRC 501(c)(3) organization constitutes prohibited political activity is a determination of whether it is, in fact, an educational activity, parti-cularly when the IRC 501(c)(3) organization advocates a

particular view-point. Rev. Proc. 86-43, 1986-2 C.B. 729, provides a methodology test for determining whether an activity is educational. It identifies several factors which indicate that the method used is not educational: (1) pre-sentation of viewpoints unsupported by facts as a significant portion of the organization's communications; (2) distorted facts; (3) substantial use of inflammatory and disparaging terms and conclusions based on strong emotional feelings rather than objective evaluations; and (4) the approach used is not aimed at developing the audience's understanding because it does not consider their background or training in the subject matter. The presence or absence of any of these factors is not con-clusive; rather, the determination of whether the method used is educational is based upon all the facts and circumstances of the situation.

Activities that meet the methodology test of Rev. Proc. 86-43 may nevertheless constitute participation or intervention in a political campaign. For example, the court in Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied 490 U.S. 1030 (1989), determined that the Association did not qualify as an organization described in IRC 501(c)(3) because it participated or intervened in a political campaign. The Association's disqualifying activity was the distribution of its ratings of candidates for elective judicial office as "approved," "not approved" or "approved as highly qualified." The ratings were made on the basis of a comparison of the candidate with ideal standards of competence, ability, and other qualities; they did not involve comparisons with other candidates. The court stated that although this activity was nonpartisan and in the public interest, it nevertheless constituted participation or intervention in a political campaign and the Association therefore did not qualify as an IRC 501(c)(3) organization. The Association's methodology apparently would pass muster under Rev. Proc. 86-43; it constituted prohibited political campaign activity nonetheless. For another example, see Rev. Rul. 67-71, 1967-1 C.B. 125, which discusses an organization created to improve a public educational system. The organization selected and supported a particular slate of candidates for the school board. The revenue ruling concludes that the organization engaged in prohibited political campaign activity, even though the selection process was completely objective and unbiased and was intended primarily to educate and inform the public about the candidates.

C. Other Issues That Arise Regarding the IRC 501(c)(3) Political Campaign Prohibition: Motivation and Absoluteness of the Prohibition

1. Does the motivation of an organization deter-mine whether the politi-cal campaign prohibition has been violated?

No, the motivation of an organization is irrelevant when determining whether the political campaign prohibition has been violated. Rev. Rul. 76-456, 1976-2 C.B. 151, touches on this point in concluding that where an organization is involved in up-grading the morals and ethics of political campaigning, it is nevertheless intervening in a political campaign if it solicits candidates to sign a code of fair campaign practices and releases the names of those candidates who sign and those candidates who refuse to sign. As noted above, the court in Association of the Bar of the City of New York v. Com-missioner, 858 F.2d 876 (2d Cir. 1988), cert. denied 490 U.S. 1030 (1989), upheld this view when it stated that although the Association's activity was nonpartisan and in the public interest, it nevertheless constituted participation or intervention in a political campaign. In explicating its conclusion, the court made the rather wry observation: "A candidate who receives a 'not qualified' rating will derive little comfort from the fact that the rating may have been made in a nonpar-tisan manner." Id. at 880. See also Rev. Rul. 67-71, 1967-1 C.B. 125.

2. Is the prohibition absolute?

Yes. In United States v. Dykema, 666 F.2d 1096, 1101 (7th Cir. 1981), the Seventh Circuit stated: "It should be noted that exemption is lost . . . by participation in any political campaign on behalf of any candidate for public office. It need not form a substantial part of the organization's activities." The Second Circuit agreed with this position when it held that an organization did not qualify as an IRC 501(c)(3) organization because it rated judicial candidates as a very minor part of its total activities. Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988), cert. denied 490 U.S. 1030 (1989). The court rejected the organization's contention that the substantiality requirement from the lobbying activity limitations be applied to the political campaign activity restriction. Citing United States v. Naftalin, 441 U.S. 768, 773 (1979), the court stated: "The short answer [to

this argument] is that Congress did not write the statute that way." Id. at 881. The court noted that the IRC 501(c)(3) prohibition against participation or intervention in political campaigns was added some twenty years after the statutory restriction on lobbying. Therefore, the court concluded: "Had Congress intended the added exception to apply only to those organizations that devote a substantial part of their activity to participation in political campaigns, it easily could have said so. It did not." Id. at 881. Furthermore, the court noted, both houses of Congress, in their Committee Reports on the Tax Reform Act of 1969, explicitly differentiated the scope of the two proscriptions: "[A]lthough the present provisions of section 501(c)(3) permit some degree of influencing legislation by a section 501(c)(3) organization, it provides that no degree of support for an individual's candidacy is permitted." Id. at 881, citing H.R. No. 91-413, 91st Cong., 1st Sess. 32 (1969), 1969-3 C.B. 200, 221; S. Rep. No. 91-552, 91st Cong., 1st Sess. 47 (1969), 1969-3 C.B. 423, 454.

3. Are the taxes set forth in IRC 4955 intermediate sanctions that could be imposed in the absence of a revocation?

Fundamentally, it appears that Congress viewed the IRC 4955 taxes, not so much as an intermediate sanction to replace revocation, but, primarily, as an additional tax, and, secondarily, as a sanction to apply instead of revocation in certain limited situations. The House Budget Committee Report (H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1623-1624 (1987)), explains the reasons for the enactment of the excise tax provisions of IRC 4955 as follows:

> "The committee believes that the penalty excise tax structure applicable under present law if a private foundation makes a prohibited political expenditure should also apply in the case of prohibited political expenditures made by a public charity.
>
> "As the Congress concluded in adopting the two-tier foundation excise tax structure in 1969, the Internal Revenue Service may hesitate to revoke the exempt status of a charitable organization for engaging in political campaign activities in circumstances where that penalty may seem to be disproportionate - i.e., where the expenditure was unintentional and involved only a small amount and where the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future, particularly where the managers responsible for the prohibited

> expenditure are no longer associated with the organization. At the same time, where an organization claiming status as a charity engages in significant, uncorrected violations of the prohibition on political campaign activities, revocation of exempt status may be ineffective as penalty or as a deterrent, particularly if the organization ceases operations after it has diverted all its assets to improper purposes.
>
> "The committee believes that the additional, two-tier excise tax structure applicable under present law to private foundations operates in a fair and effective manner and hence appropriately should be extended to public charities. The adoption of the excise tax sanction does not modify the present-law rule that an organization does not qualify for tax-exempt status as a charitable organization, and is not eligible to receive tax-deductible contributions, unless the organization does not participate in, or intervene in, any political campaign on behalf of or in opposition to any candidate for public office (secs. 501(c)(3), 170(c)(2))." (Emphasis supplied.)

The House Budget Committee Report, therefore, specifies the situations in which Congress intended that the Service consider utilizing the excise tax instead of revocation -- where the violation was unintentional, involved only a small amount, and the organization had subsequently corrected the violation and adopted procedures to assure that similar expenditures would not be made in the future. (The House Budget Committee Report's use of "i.e.," instead of "e.g.," is significant.) Furthermore, the legislative history points out that the enactment of IRC 4955 was not intended to modify the political campaign activity prohibition of IRC 501(c)(3). Instead, Congress intended the excise tax be imposed even when the IRC 501(c)(3) organization loses its tax-exempt status as a result of the prohibited political campaign activity -- it observed that in some situations revocation alone was ineffective as a penalty. Finally, Congress intended IRC 4955 to operate as a deterrent -- the same penalty/deterrent motivation that underlay enactment of the Chapter 42 taxes (one of which was IRC 4945) on private foundations in 1969.

The 1987 enactments were intended to strengthen, not to weaken, the prohibition on political campaign activity. As noted at the beginning of this article, at the same time that Congress enacted IRC 4955, it enacted other provisions to strengthen the ability of the Service to enforce the political campaign prohibition: the termination assessment provisions of IRC 6852,

the injunctive provisions of IRC 7409, and the amendment to IRC 504 to make qualification under IRC 501(c)(4) unavailable to an organization that has lost IRC 501(c)(3) status due to political campaign activity.

In summary, the Service is interested in a flexible approach to tax administration. We can derive flexibility through other mechanisms, such as settlement and closing agreements, if the circumstances of particular cases warrant. However, with respect to IRC 4955, two considerations are paramount: (1) Congress intended it is a supplement to the IRC 501(c)(3) prohibition to be considered as a substitute only in limited, specified situations; and (2) the tax/correction structure of IRC 4955 does not appear to lend itself to situations where there is a clear endorsement or a clear statement of opposition to a candidate -- when these occur, the genie is out of the bottle and to make the correction that IRC 4955 requires, to get the genie back, would be a task that strains the imagination.

D. Particular Situations Involving the Application of Facts and Circumstances Tests

1. To what extent may an IRC 501(c)(3) organization's publication contain material relating to candidates during an election campaign?

Frequently, IRC 501(c)(3) organizations publish periodicals, including magazines and weekly newspapers. These periodicals contain various stories of interest to the readership, including discussions of various issues of importance to the organization. During an election campaign, news stories, by definition, may involve reporting on a particular candidate's activities.

The fundamental distinction here is between what is news coverage and what is an attempt through editorial policy to promote or oppose a particular candidate. Questions, of necessity, are highly factual, but the overall focus is on the policy of the organization. What does the publication normally do when it covers news stories? Does it have a policy of only covering particular candidates? Does it, in fact, only cover particular candidates? Is the coverage slanted to show any particular candidate in a favorable or unfavorable light?

2. What are the rules relating to publication of legislators' voting records?

A number of IRC 501(c)(3) organizations publish "voters guides." These publications contain the voting records of incumbent legislators and are distributed with the stated purpose of educating voters. Some of the facts and circumstances to be considered in determining whether the publication of these voters guides constitutes prohibited political campaign activity are whether the incumbents are identified as candidates; whether the incumbents' positions are compared to the positions of other candidates or the organization's position; the timing, extent, and manner in which the voters guide is distributed; and the breadth or narrowness of the issues presented in the voters guide.

An IRC 501(c)(3) organization that annually prepared a compilation of voting records of all members of Congress on major legislation involving a wide range of subjects and made it generally available to the public was not participating or intervening in a political campaign. The compilation contained no editorial opinion and its contents and structure did not indicate approval or disapproval of any members or their voting records. Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 1. On the other hand, an IRC 501(c)(3) organization that compiled the voting records of incumbents on selected land conservation issues of importance to the organization and distributed the compilation widely among the electorate during an election campaign did participate or intervene in a political campaign. Although the guide contained no express statements in support of or in opposition to any candidate, the organization concentrated on a narrow range of issues in the voters guide and widely distributed it among the electorate during an election campaign, which indicated that its purpose was not nonpartisan voter education. Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 4.

Rev. Rul. 80-282, 1980-2 C.B. 178, discusses a situation where an IRC 501(c)(3) organization intended to publish a summary of the voting records of all incumbent members of Congress on selected legislative issues of importance to the organization. The summary would be published as soon as was practicable after the close of the congressional session in a regular issue of its monthly newsletter, which would be distributed to the usual subscribers. The newsletter would indicate the organization's position on the issues and the summary would indicate whether each legislator voted in accordance with the organization's position on each issue. The newsletter

was politically nonpartisan and would not contain any reference to or mention of any political campaigns, elections, or candidates or any statements expressly or impliedly endorsing or rejecting any incumbent as a candidate for public office. In addition, no mention would be made of an individual's overall qualification for public office, the newsletter would not compare candidates who might be competing with the incumbent for public office, and the newsletter would point out the limitation of judging the qualifications of an incumbent on the basis of a few selected votes. The summary would contain the voting records of all incumbents and candidates for reelection would not be identified as such. The publication of the voting records would not be geared to the timing of any federal election and distribution would not be targeted toward particular areas in which elections were occurring. The ruling holds that the organization was not participating or intervening in a campaign within the meaning of IRC 501(c)(3), even though the organization indicated whether the votes of the incumbents agreed with its position. The critical factors here were that the timing and distribution of the newsletter indicated its publication was not aimed at any elections and the newsletter did not identify which of the incumbents were candidates for reelection.

3. *What are the rules relating to candidate questionnaires?*

Another activity of IRC 501(c)(3) organizations that may qualify as educational is the publication of candidate questionnaires. These questionnaires, the results of which are distributed to the voting public, typically consist of candidates' responses to questions posed by the organization. Some of the facts and circumstances considered in determining whether the publication of the questionnaire constitutes prohibited political campaign activity are as follows:

(A) Whether the questionnaire is sent to all candidates;

(B) Whether all responses are published;

(C) Whether the questions indicate a bias toward the organization's preferred answer;

(D) Whether the responses are compared to the organization's positions on the issues; and

(E) Whether the responses are published as received without editing by the organization.

Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 2, describes an IRC 501(c)(3) organization that solicited from all candidates for governor a brief statement of the candidate's position on a wide variety of issues. The results then were published in a voters guide made generally available to the public. The issues were selected by the organization solely on the basis of their interest and importance to the electorate as a whole and neither the questionnaire nor the voters guide, in content or structure, evidenced a bias or preference with respect to the views of any candidate or group of candidates. The revenue ruling holds that the organization had not participated or intervened in a political campaign within the meaning of IRC 501(c)(3). On the other hand, an IRC 501(c)(3) organization that published a voters guide based on responses from candidates to a questionnaire did participate or intervene in a political campaign when the questions to the candidates evidenced a bias on certain issues. Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 3.

4. What are the rules relating to public forums?

Public forums involving candidates for public office may qualify as exempt educational activities. However, if the forum is operated to show a bias for or against any candidate, then the forum would be prohibited activity as it would constitute an intervention or participation in a political campaign.

An IRC 501(c)(3) organization that operated a noncommercial broadcasting station presenting religious, educational, and public interest programs did not participate in political campaigns within the meaning of IRC 501(c)(3) when it made free air time available to all legally qualified candidates in accordance with the requirements of the Federal Communications Act of 1934. The organization made reasonable amounts of air time available without charge to all legally qualified candidates on an equal basis. Before and after each broadcast, the station made a statement indicating that the views expressed were those of the candidate, and not of the station; that the station endorsed no candidate; that the presentation was made as a public service; and that equal opportunities would be presented to all legally qualified candidates for the same public office to present their views. Rev. Rul. 74-574, 1974-2 C.B. 160.

Rev. Rul. 86-95, 1986-2 C.B. 73, describes public forums involving qualified congressional candidates that were sponsored by an IRC 501(c)(3) organization and holds that the conduct of these forums does not constitute participation or intervention in any political campaign within the meaning of IRC 501(c)(3). In that instance, the following facts and circumstances were considered:

(A) All legally qualified candidates were invited;

(B) The questions were prepared and presented by an independent nonpartisan panel;

(C) The topics discussed covered a broad range of issues of interest to the public;

(D) Each candidate had an equal opportunity to present his or her views on the issues discussed; and

(E) The moderator did not comment on the questions or otherwise make comments that implied approval or disapproval of any of the candidates.

However, the revenue ruling indicates that the presence or absence of any of these factors in similar situations is not determinative -- they would need to be considered in light of all of the surrounding factors in any particular case.

An IRC 501(c)(3) organization may hold a debate during the primary election season that is limited to legally qualified candidates for the nomination of a particular political party. In Fulani v. League of Women Voters Education Fund, 882 F.2d 621 (2d Cir. 1989), the court held that the League of Women Voters Education Fund, an IRC 501(c)(3) organization, did not violate the political campaign prohibition when it did not invite Dr. Lenora B. Fulani to participate in any of three debates that it sponsored. Two of the three debates were between candidates for the Democratic nomination for President, while the third was between candidates for the Republican nomination. Dr. Fulani was an independent and minor party candidate for the office of President. She was refused an invitation to participate because she was not seeking either the Democratic or Republican nomination. The court noted the distinction between primary and general elections and indicated that the purpose of the debates was to educate voters

about the candidates seeking the Democratic or Republican nomination. Since Dr. Fulani was not seeking either nomination, the failure to invite her to participate in the debates did not constitute participation or intervention in a political campaign.

Many times, the number of legally qualified candidates for a particular office is so large that an IRC 501(c)(3) organization may determine that holding a debate to which all legally qualified candidates were invited would be impractical and would not further the educational purposes of the organization. For example, in 1988, more than 280 people declared themselves to be candidates for the office of President and, for the 1992 election, approximately 250 people had declared themselves to be candidates for the Presidency as of early June 1992. The FEC regulations provide that an IRC 501(c)(3) organization may stage nonpartisan candidate debates, the structure of which is left to the discretion of the organization, provided that such debates include at least two candidates and are nonpartisan in that they do not promote or advance one candidate over another. 11 C.F.R. sec. 110.13. In determining whether an IRC 501(c)(3) organization participates or intervenes in a political campaign when it holds a candidate debate to which not all legally qualified candidates are invited, all the facts and circumstances must be considered, including the following:

(A) Whether inviting all legally qualified candidates is impractical;

(B) Whether the organization adopted reasonable, objective criteria for determining which candidates to invite;

(C) Whether the criteria were applied consistently and non-arbitrarily to all candidates; and

(D) Whether other factors, such as those discussed in Rev. Rul. 86-95, indicate that the debate was conducted in a neutral, nonpartisan manner.

5. What are the rules relating to IRC 501(c)(3) organi-zations that operate broadcast stations?

In general, an IRC 501(c)(3) organization that operates a noncommercial broadcast station will not be considered to have participated or intervened in a political campaign if it complies with FCC regulations concerning access to air time by candidates. Noncommercial broadcast stations are prohibited from supporting or opposing candidates for public office. 47 U.S.C. sec. 399. They are also prohibited from broadcasting in exchange for remuneration messages or other materials that are intended to support or oppose any candidate for political office. 47 U.S.C. sec. 399b. An IRC 501(c)(3) organization that operates a noncommercial broadcast station is not required to permit the use of its facilities by any legally qualified candidate for any public office. However, if an organization permits a legally qualified candidate for any public office to use a broadcasting station, it must give all other legally qualified candidates for that office an equal opportunity to use the broadcasting station. For these purposes, use of the broadcasting station does not include the "[a]ppearance by a legally qualified candidate on any -- (1) bona fide newscast, (2) bona fide news interview, (3) bona fide news documentary (if the appearance of the candidate is incidental to the presentation of the subject or subjects covered by the news documentary), or (4) on-the-spot coverage of bona fide news events (including but not limited to political conventions and activities incidental thereto)." 47 U.S.C. sec. 315(a). In applying these rules, a broadcasting station is not required to invite all legally qualified candidates for a particular office to appear on the same program. See, Re Socialist Workers 1970 New York State Campaign Committee, 26 F.C.C.2d 38 (1970).

Rev. Rul. 74-574, 1974-2 C.B. 160, describes an IRC 501(c)(3) organization that operated a noncommercial broadcasting station presenting religious, educational, and public interest programs. In accordance with the requirements of the Federal Communications Act of 1934, the organization made reasonable amounts of air time available without charge to all legally qualified candidates on an equal basis. Before and after each broadcast, the station made a statement indicating that the views expressed were those of the candidate and not of the station; that the station endorsed no candidate; that the presentation was made as a public service; and that equal opportunities would be presented to all legally qualified candidates for the same public office to present their views. The ruling holds that the

organization did not participate in political campaigns within the meaning of IRC 501(c)(3) when it made free air time available to all legally qualified candidates.

6. What are the rules relating to colleges and universi-ties?

As IRC 501(c)(3) organizations, colleges and universities are prohibited from participating or intervening in any political campaign on behalf of or in opposition to a candidate for public office. In order to constitute participation or intervention in a political campaign, however, the political activity must be that of the college or university and not the individual activity of its faculty, staff, or students.

Rev. Rul. 72-512, 1972-2 C.B. 246, describes a university that provided a political science course to acquaint students with the basic techniques of effective participation in the electoral process. The course was open to all students and consisted of several weeks of classroom work followed by two weeks in which the student was excused from class to participate in the political campaign of a candidate chosen by the student. The student was required to spend between 60 and 80 hours on campaign work and write a paper evaluating the experience. The university did not influence the choice of candidates and was reimbursed or paid for any services or facilities provided to the students for use in connection with the campaigns. The ruling holds that the university was not participating in political campaigns within the meaning of IRC 501(c)(3). Since the extent and manner of student participation in the real political process was reasonably germane to the course of instruction, the fact that the course was part of the university's curriculum and that university facilities and staff were employed in its conduct did not cause the political activity of the individual students to be attributed to the university.

Similarly, a university that provided office space and financial support for the publication of a student newspaper and made available several professors to serve as advisors to the staff was not participating in a political campaign within the meaning of IRC 501(c)(3) when the student newspaper published students' editorials on political matters. The newspaper provided training for students in various aspects of newspaper publication (including editorial policy) and was distributed primarily to students of the university. Editorial policy was determined by the student editors and not by the university or the faculty advisors. A statement on the editorial page clearly

indicated that the views expressed were those of the students and not of the university. The political activities of the student editors were not attributed to the university despite the university's provision of support to the newspaper. Rev. Rul. 72-513, 1972-2 C.B. 246.

Colleges and universities frequently make facilities available to student groups and others. Whether the provision of facilities to a group for the conduct of political campaign activities will constitute participation or intervention in a political campaign by the college or university will depend upon all the facts and circumstances, including whether the facilities are provided on the same basis that the facilities are provided to other non-political groups and whether the facilities are made available on an equal basis to similar groups.

7. What are the rules pertaining to voter registration?

An IRC 501(c)(3) organization may conduct a voter registration or get-out-the-vote drive without being considered to participate or intervene in a political campaign so long as it is conducted in a nonpartisan manner. (There are, however, special rules pertaining to private foundations -- these are discussed in the question and answer immediately below.) The determination of whether the drive is conducted in a nonpartisan manner is based upon all the facts and circumstances. FEC regulations identify the following factors that may be considered in determining whether a voter registration or get-out-the-vote communication is nonpartisan: (1) either no candidate is named or depicted or all candidates for a particular Federal office are named or depicted without favoring any candidate over any other; (2) it names no political party except that it may identify the political party affiliation of all candidates named or depicted; and (3) it is limited to urging acts such as voting and registering and to describing the hours and places of registration and voting. 11 C.F.R. sec. 114.4(b)(2). The FEC regulations also provide that one condition of nonpartisan voter registration and get-out-the-vote drives is that all services be made available without regard to the voter's political preference. 11 C.F.R. sec. 114.4(c)(1). Similar factors should be considered in determining whether an IRC 501(c)(3) organization is participating or intervening in a political campaign when it conducts a voter registration or get-out-the-vote drive, although other facts and circumstances may also have to be considered.

8. What are the special voter registration rules that pertain to private foundations?

Under IRC 4945(d)(2), amounts paid or incurred by a private foundation to influence the outcome of any specific public election or to carry on, directly or indirectly, any voter registration drives are taxable expenditures subject to tax under IRC 4945, unless such amounts are paid or incurred by an organization described in IRC 4945(f).

Reg. 53.4945-3(a)(2) provides that activities considered to constitute political campaign participation or intervention include, but are not limited to --

(A) Publishing or distributing written or printed statements or making oral statements on behalf of or in opposition to a candidate;

(B) Paying salaries or expenses of campaign workers; and

(C) Conducting or paying the expenses of conducting a voter registration drive limited to the geographic area covered by the campaign.

However, a private foundation may distribute amounts for voter registration drives, or make grants for voter registration drives to other organizations, and the amounts will not be considered taxable expenditures, if the following requirements, described in IRC 4945(f) and Reg. 53.4945-3(b)(1), are met:

(A) The voter registration drive expenditures must be made by an IRC 501(c)(3) organization;

(B) The organization's activities are nonpartisan, are not confined to one specific election period, and are carried on in five or more states;

(C) The organization spends at least 85 percent of its income directly for the active conduct of its exempt purpose activities;

(D) The IRC 501(c)(3) organization must receive no more than half of its support from gross investment income and at least 85 percent of its support other than gross investment income must be from exempt organizations, the general public, and governmental units, with no more than 25 percent of its support received from any one exempt organization; and

(E) The contributions to the organization for voter registration drives may not be subject to conditions that they may be used only in specified locations or only for one specific election period.

An organization that believes it can meet these requirements may seek an advance ruling to that effect. Reg. 53.4945-3(b)(4). See, e.g., PLR 92-23-050 (March 10, 1992) (organization promoting voting rights of homeless meets criteria for classification as organization described in IRC 4945(f)).

9. Other than the private foundation voter registration rules, are there any other special rules pertaining to a specific type of IRC 501(c)(3) organization?

Certain expenditures of candidate-controlled organizations are considered political expenditures for the purpose of the tax imposed by IRC 4955. A candidate-controlled organization is an organization formed primarily for the purpose of promoting the candidacy or prospective candidacy of an individual for public office or one that is effectively controlled by a candidate or prospective candidate and that is availed of primarily for such purposes.[7] According to the legislative history, an organization is "effectively controlled" by a candidate if the candidate "has a continuing, substantial involvement in the day-to-day operations or management of the operation." H.R. Conf. Rep. No. 100-495, 100th Cong., 1st Sess. 1021 (1987), 1987-3 C.B. 193, 301. The expenditures of a candidate-controlled organization that are considered political expenditures under IRC 4955(d)(2) are as follows:

[7] As originally proposed, a candidate-controlled organization was an organization formed, or availed of, substantially for purposes of promoting the candidacy or potential candidacy of an individual for public office. H.R. 2942, "Tax Exempt Lobbying and Political Activities Accountability Act of 1987" (July 15, 1987). The change from "substantially" to "primarily" was one of the few changes in the final enactment.

(A) Amounts paid or incurred to the candidate for speeches or other services;

(B) Travel expenses of the candidate;

(C) Expenses of conducting polls, surveys or other studies, or preparing papers or other materials for use by the candidate;

(D) Expenses of advertising, publicity and fundraising for the candidate; and

(E) Any other expense that has the primary effect of promoting public recognition or otherwise primarily accruing to the benefit of the candidate.

10. May an IRC 501(c)(3) organization invite candidates to speak at its events?

An IRC 501(c)(3) organization may invite a candidate to speak at its events without being considered to have participated or intervened in a political campaign depending upon the facts and circumstances of the invitation. Candidates may be invited to speak at an event of an IRC 501(c)(3) organization either in their capacity as a candidate or in their individual capacity other than as a candidate. The facts and circumstances to be considered are dependent upon the capacity in which the candidate is invited to speak.

When a candidate is invited to speak at an event in his or her capacity as a candidate, the IRC 501(c)(3) organization may be considered to have participated or intervened in a political campaign unless it takes steps to ensure that there is no indication of support of or opposition to the candidate by the organization. One step that an IRC 501(c)(3) organization should take is to state explicitly that it does not support or oppose the candidate when the candidate is introduced and in any communications concerning the candidate's attendance at the event. Additionally, absolutely no political fundraising should occur at the event. Other factors to be considered include those discussed in the public forum cases, although the circumstances should be reviewed more carefully when the candidates are not participating in the same event. Those factors are the following:

(A) Whether all legally qualified candidates were invited;

(B) Whether questions for the candidate were prepared and presented by an independent nonpartisan panel;

(C) Whether the topics discussed by the candidates covered a broad range of issues of interest to the public;

(D) Whether each candidate was given an equal opportunity to present his or her views on the issues discussed; and

(E) Whether a moderator commented on the questions or otherwise made comments that implied approval or disapproval of any of the candidates.

In determining whether candidates are given an equal opportunity to participate, the nature of the event to which each candidate is invited should be considered in addition to the manner of presentation. An IRC 501(c)(3) organization that invites one candidate to speak at its main banquet of the year and invites an opposing candidate to speak at a sparsely attended general meeting will likely be found to have violated the political campaign prohibition, even if the manner of presentation for both speakers is otherwise neutral. Similarly, an IRC 501(c)(3) organization that invites two opposing candidates to speak at its events with the knowledge and expectation that one will not accept the invitation because of well-known opposing viewpoints may not be considered to have provided an equal opportunity to all candidates.

Candidates may also be invited to speak at events by IRC 501(c)(3) organizations in their capacity other than as a candidate. Many candidates are public figures for reasons other than their candidacy. For instance, a number of candidates either currently hold or formerly held public office or may be experts in a non-political field. A candidate also might be a public figure as a result of a prior career, such as an acting, military, legal, or public service career. When a candidate is invited to speak at an event in a capacity other than as a candidate, it is not necessary for the IRC 501(c)(3) organization to provide equal access to all candidates. However, the IRC 501(c)(3) organization must ensure that the candidate speaks only in the other capacity and not as a candidate, that no mention is made of the individual's candidacy at the event, and that no campaign activity occurs in connection with the candidate's attendance at the event. In addition, all communications regarding the candidate's attendance at the event should clearly indicate the capacity in which the candidate is acting and should not mention the individual's candidacy. Even if the candidate

does not engage in any campaign activity at the event, if the primary purpose for the invitation to the candidate is to provide public exposure for the candidate, the IRC 501(c)(3) organization may be participating or intervening in a political campaign. If the invitation to the candidate otherwise qualifies, the mere payment of customary and usual honoraria to the candidate should not cause the IRC 501(c)(3) organization to violate the political campaign prohibition. However, when the payment of honoraria is intended to support the speaker's campaign, then the IRC 501(c)(3) organization will have violated the political campaign prohibition. The determination of whether the IRC 501(c)(3) organization has participated or intervened in a political campaign will be based on all the facts and circumstances of the particular situation.

E. Situations Involving Business Activities

1. What are the general rules concerning business activities in relationship to the concept of participation or intervention in a political campaign?

The question of whether an activity constitutes participation or intervention in a political campaign may also arise in the context of a business activity of the IRC 501(c)(3) organization, such as the selling or renting of mailing lists or the acceptance of paid political advertising. In this context, some of the factors to be considered in determining whether the IRC 501(c)(3) organization has engaged in prohibited political campaign activity are the following:

(A) Whether the activity is realistically available to all candidates on an equal basis;

(B) Whether the activity is available only to candidates and not to the general public; and

(C) Whether the activity is an ongoing activity of the organization or whether it is conducted for the first time for the candidate.

Ultimately, what the Service is looking for here is a track record. Is this truly the kind of activity or service that the organization has offered before and continues to offer on a nonpartisan basis? Does it truly hold itself out as providing these services to other organizations? To other candidates?

Has it done so in the past? While a first time attempt to provide an activity or service of the type under discussion does not necessarily characterize it as prohibited political campaign activity, the more recent the institution of the activity or service, the lower the Service's comfort level is going to be. In addition, other facts and circumstances, such as what the relationship is between the organization and the candidate for whom the work is being performed and whether the fee charged for the services is truly set at a fair market rate, should be considered in determining whether the IRC 501(c)(3) organization has violated the political campaign prohibition.

2. To what extent may an IRC 501(c)(3) organization sell or rent its mailing list to candidates?

An IRC 501(c)(3) organization that regularly sells or rents its mailing list to other organizations will not violate the political campaign prohibition if it sells or rents the list to a candidate on the same terms the list is sold or rented to others, provided the list is equally available to all other candidates on the same terms. On the other hand, an IRC 501(c)(3) organization that sells or rents its mailing list to certain candidates, without making it available to all other candidates, will violate the political campaign prohibition. In determining whether the mailing list is equally available to all other candidates, it must be shown that all candidates were afforded a reasonable opportunity to acquire the list. To ensure the list is equally available to all candidates, an IRC 501(c)(3) organization should inform the candidates of the availability of the list. If the organization has never previously rented its mailing list, the value assigned to the mailing list must be given extra scrutiny to ensure that the fee charged is a fair market rate.

3. May an IRC 501(c)(3) organization accept paid political advertising for its publication?

A number of IRC 501(c)(3) organizations accept paid advertising for their publications. An IRC 501(c)(3) organization that accepts paid political advertising may not be violating the political campaign prohibition if it accepts the advertisement on the same basis as other non-political advertising, provided the advertisement is identified as paid political advertising, the organization expressly states that it does not endorse the candidate, and advertising is available to all candidates on an

equal basis. In determining whether advertising is available to all candidates on an equal basis, consideration should be given to the manner in which the advertising is solicited. For example, an IRC 501(c)(3) organization may not be making advertising in its publication available to all candidates on an equal basis when it expressly solicits advertising from certain candidates that support its views and merely indicates that it would accept advertising from other candidates without soliciting advertising from them or otherwise informing them that such advertising opportunities are available. The manner of presentation of the paid political advertisement also should be considered in determining whether the organization has violated the political campaign prohibition.

Although paid political advertising may not constitute participation or intervention in a political campaign, it will generate unrelated business taxable income for the IRC 501(c)(3) organization. While the Supreme Court did not expressly adopt a per se rule that advertising was an unrelated business, it indicated that advertising was an unrelated business except in the extremely rare case in which the organization could demonstrate that its advertising policy was explicitly designed to further its exempt purpose. United States v. American College of Physicians, 475 U.S. 834 (1986). Since political campaign activity is prohibited, the acceptance of paid political advertising would not further the exempt purpose of an IRC 501(c)(3) organization.

F. Attribution of the Acts of Individuals to IRC 501(c)(3) Organizations

1. When may the act of an individual official of an IRC 501(c)(3) organization be attributed to the organization, for purposes of the political campaign prohibition?

The prohibition on political campaign activity applies only to IRC 501(c)(3) organizations, not to the activities of individuals in their private capacity. The prohibition against political campaign activity does not prevent an organization's officials from being involved in a political campaign, so long as those officials do not in any way utilize the organization's financial resources, facilities, or personnel, and clearly and unambiguously indicate that the actions taken or the statements made are those of the individuals and not of the organization.

On the other hand, since an IRC 501(c)(3) organization acts through individuals, sometimes the political activity of an individual may be attributed to the organization. As in other situations where the political campaign prohibition is concerned, the determination of whether the act of an individual will be attributed to an IRC 501(c)(3) organization is based on the relevant facts and circumstances. In particular, when officials of an IRC 501(c)(3) organization engage in political activity at official functions of the organization or through the organization's official publications, the actions of the officials are attributed to the IRC 501(c)(3) organization. Use of the IRC 501(c)(3) organization's financial resources, facilities, or personnel is also indicative that the actions of the individual should be attributed to the organization.

An IRC 501(c)(3) organization acts through individuals such as its officers, directors and trustees. The officers, directors, or trustees of the organization are the ones who make the decisions for the organization and communicate those decisions to others. Officials acting in their individual capacity may be identified as officials of the organization so long as they make it clear that they are acting in their individual capacity, that they are not acting on behalf of the organization, and that their association with the organization is given for identification purposes only. If it is not made clear that the official's association with the organization is given only for purposes of identification, the individual's acts may be attributed to the IRC 501(c)(3) organization since the organization typically acts through its officials. Actions and communications by the officials of the organization that are of the same character and method as authorized acts and communications of the organization will be attributed to the organization.

2. When may the acts of individuals other than officials of the organization be attributed to an IRC 501(c)(3) organization, for purposes of the political campaign prohibition?

An IRC 501(c)(3) organization may also act or communicate with others through the authorized actions of its employees or members. There must be real or apparent authorization by the IRC 501(c)(3) organization of the actions of individuals other than officials before the actions of those individuals will be attributed to the organization. In general, the principles of agency will be applied to determine whether an individual engaging in political activity was acting

with the authorization of the IRC 501(c)(3) organization. G.C.M. 34631 (Oct. 4, 1971). The actions of employees within the context of their employment generally will be considered to be authorized by the organization.

Acts of individuals that are not authorized by the IRC 501(c)(3) organization may be attributed to the organization if it explicitly or implicitly ratifies the actions. A failure to disavow the actions of individuals under apparent authorization from the IRC 501(c)(3) organization may be considered a ratification of the actions. To be effective, the disavowal must be made in a timely manner equal to the original actions. The organization must also take steps to ensure that such unauthorized actions do not recur.

The actions of students generally are not attributed to an educational institution unless they are undertaken at the direction of and with authorization from a school official. (Note that actions by a person in excess of his official authority should not, as a rule, be considered those of the organization. If the organization allows such usurpation of authority to go unchallenged, however, it impliedly ratifies the act. G.C.M. 34523 (June 11, 1971).) For instance, the individual political campaign activities of students were not attributed to the university in Rev. Rul. 72-512, 1972-2 C.B. 246. Had the faculty members specified the candidates on whose behalf the students should campaign, the actions of the students would be attributable to the university since the faculty members act with the authorization of the university in teaching classes.

In G.C.M. 39414 (Feb. 29, 1984), the political campaign activities of individual members were attributed to an IRC 501(c)(3) organization. The organization's publication stated that the organization would be sending members to work on the campaign, members identified themselves as representing the organization, and officials made no effort to prevent the members' activities.

G. Relationship of IRC 501(c)(3) Organizations with Organizations That Conduct Political Campaign Activities

1. Can an IRC 501(c)(3) organization establish a political action committee (PAC) to engage in political campaign activity without the PAC's activities being attributed to the parent IRC 501(c)(3) organization?

No. When the statute governing political organizations, IRC 527, was enacted, the Senate Finance Committee's Report stated: "This provision is not intended to affect in any way the prohibition against certain exempt organizations (e.g., sec. 501(c)(3)) engaging in 'electioneering' or the application of the provisions of section 4945 to private foundations." S. Rep. No. 93-1374, 93d Cong., 2d Sess. 30 (1974), 1975-1 C.B. 517, 534. Consequently, Reg. 1.527-6(g) provides:

> "Section 527(f) and this section do not sanction the intervention in any political campaign by an organization described in section 501(c) if such activity is inconsistent with its exempt status under section 501(c). For example, an organization described in section 501(c)(3) is precluded from engaging in any political campaign activities. The fact that section 527 imposes a tax on the exempt function income (as defined in section 1.527-2(c)) expenditures of section 501(c) organizations and permits such organizations to establish separate segregated funds to engage in campaign activities does not sanction the participation in these activities by section 501(c)(3) organizations."

2. May the directors of an IRC 501(c)(3) organization form a PAC without it being attributed to the IRC 501(c)(3) organization?

This question frequently arises because the FEC, in Advisory Opinion 1984-12 (May 31, 1984), allowed the directors of a charitable corporation, acting in their individual capacities, to establish a non-connected political action committee. The opinion held that this did not violate the FECA prohibition on corporate involvement in elections since it was the directors and not the charitable corporation that established the PAC.

What was stated at the outset of the discussion of attribution bears repeating here: The prohibition on political campaign activity applies only to IRC 501(c)(3) organizations, not to the political campaign activities of individuals in their private capacity. The prohibition against political campaign activity does not prevent an organization's officials from being involved in a political campaign, so long as those officials do not in any way utilize the organization's financial resources, facilities, or personnel, and clearly and unambiguously indicate that the actions taken or the statements made are those of the individuals and not of the organization. Whether the individuals are truly acting in their own capacity is an evidentiary question. Unfavorable evidence would include any similarity of name between the IRC 501(c)(3) organization and the PAC, any excessive overlap of directors without a convincing explanation for the situation, and any sharing of facilities.

3. When will the political activities of a related IRC 501(c)(4) organization (or its separate segregated fund) be attributed to an IRC 501(c)(3) organization?

A number of IRC 501(c)(3) organizations have related IRC 501(c)(4) organizations that conduct political campaign activities, usually through a PAC (an IRC 527(f) separate segregated fund). So long as the organizations are kept separate (with appropriate record keeping and fair market reimbursement for facilities and services), the activities of the IRC 501(c)(4) organization or of the PAC will not jeopardize the IRC 501(c)(3) organization's exempt status. However, the political campaign activities of the affiliated IRC 501(c)(4) organization, or of the PAC it establishes, should not be an attempt to accomplish indirectly what the IRC 501(c)(3) organization could not do directly. Facts and circumstances prevail here also.

In Regan v. Taxation with Representation of Washington, 461 U.S. 540 (1983), the Supreme Court upheld the prohibition of substantial lobbying by IRC 501(c)(3) organizations. Taxation with Representation of Washington ("TWR") was an organization that applied for recognition of exemption from federal income tax as an organization described in IRC 501(c)(3), but was denied because it proposed to engage in substantial lobbying activity. TWR was the successor to two other organizations, an IRC 501(c)(3) organization and a related IRC 501(c)(4) organization. TWR itself would have qualified

as an IRC 501(c)(4) organization. The Court noted that the two primary differences between IRC 501(c)(3) organizations and IRC 501(c)(4) organizations are that contributions to IRC 501(c)(3) organizations are tax-deductible while contributions to IRC 501(c)(4) organizations are not and that IRC 501(c)(4) organizations are permitted to engage in substantial lobbying activities to advance their exempt purposes while IRC 501(c)(3) organizations are not. The Court stated that it was not unconstitutional for Congress to provide that tax-deductible contributions could not be used to support substantial lobbying activities by tax-exempt organizations. The concurring opinion expressly relied on the fact that an IRC 501(c)(3) organization could establish a related IRC 501(c)(4) organization to conduct substantial lobbying activities. So long as the two organizations are separately incorporated and maintain adequate records to show that tax-deductible contributions are not used to support the substantial lobbying activities of the IRC 501(c)(4) organization, those activities will not be attributed to the IRC 501(c)(3) organization.

A similar distinction arises concerning political campaign activities. An IRC 501(c)(4) organization is permitted to engage in some political campaign activity while an IRC 501(c)(3) organization may not. As in the case of substantial lobbying activities, the organizations must be separately incorporated and maintain adequate records to ensure that tax-deductible contributions are not used to support the political campaign activity of the IRC 501(c)(4) organization or any PAC it establishes.

Situations of particular concern when an IRC 501(c)(3) organization has a related IRC 501(c)(4) organization include those in which the two organizations share staff, facilities, or other expenses or in which the two organizations conduct joint activities requiring an allocation of income and expenses. Any allocation of income or expenses between the two organizations must be carefully reviewed to ensure that the allocation method is appropriate and that the resources of the IRC 501(c)(3) organization are not being used to subsidize the political campaign activity of the IRC 501(c)(4) organization or its PAC. The determination of whether the allocation method used is appropriate is based upon the facts and circumstances. An arm's length standard must be utilized.

An IRC 501(c)(3) organization's resources include intangible assets, such as its goodwill, that may not be used to support the political campaign activities of another organization. Any attempt at joint fundraising should be carefully scrutinized from the aspect of whether the IRC 501(c)(3)

organization is allowing its name or its goodwill to be used to further an activity forbidden to it. For example, if a well-known IRC 501(c)(3) organization "jointly" sponsors a fundraising event with a lesser-known PAC, there is a strong suspicion that the IRC 501(c)(3) organization's drawing power is being used to aid the political intervention activities of the PAC.

H. Charity/PAC Matching Programs

1. What is a Charity/PAC matching program?

Charity/PAC matching programs have been described in several opinions issued by the FEC. (See, e.g., FEC Advisory Opinion 1989-7, June 30, 1989.) Typically, such a program allows corporate employees to designate an IRC 501(c)(3) organization as the recipient of a contribution equal to the sum of the contributions that the employee made to the corporation's affiliated PAC in the previous year. The program generally excludes all IRC 501(c)(3) organizations that provide any benefits in return for contributions. Several FEC opinions conclude that the matching of affiliated PAC contributions with charitable donations is not a means of exchanging treasury funds for voluntary contributions, which is prohibited by 11 C.F.R. sec. 114.5(b). Rather, it is a permissible solicitation expense under 2 U.S.C. sec. 441b(b)(2).

2. Are grants to IRC 501 (c)(3) organizations that are made by corporate donors under a Charity/ PAC matching program recharacterized as the payment of income to the employee that is subsequently donated by the employee to the IRC 501 (c)(3) organization?

A Charity/PAC matching program grant to an IRC 501(c)(3) organization should not be recharacterized as payment of compensation to the employee, and a subsequent payment by the employee to the IRC 501(c)(3) organization.

In Rev. Rul. 79-121, 1979-1 C.B. 61, a government official received an honorarium for making a speech to a professional society. The ruling concludes that the payment must be included in the

official's gross income, even though the official requested that the payment be transferred to an IRC 501(c)(3) organization. The ruling also holds that the official, rather than the professional society, is entitled to a deduction under IRC 170 with respect to that amount.

However, under Rev. Rul. 67-137, 1967-1 C.B. 63, the right of certain employees to designate IRC 501(c)(3) organizations to which their employer will make contributions is not income to the employee. Furthermore, the contribution is deductible by the corporation to the extent provided by IRC 170. The rationale for not treating the employee's right to designate charitable recipients as compensation is that "[t]he employees are merely performing administrative duties for the corporation by suggesting specific qualified recipient organizations."

In a related area, Rev. Rul. 79-9, 1979-1 C.B. 125, which explains the acquiescence of the Service in Knott v. Commissioner, 67 T.C. 681 (1977), holds that a charitable contribution by a corporation is not taxable as a dividend to the corporation's controlling shareholders (in spite of shareholder control over the selection of the charitable donee), unless property or an economic benefit is received by the controlling shareholders or their families.

The conclusion drawn from a comparison of these rulings is that, when an IRC 501(c)(3) organization is designated to be the recipient of a payment by a person providing services for the payor, the payment is not treated as compensation unless it is in return for specific and identifiable services, so that the payment represents a mere assignment of income. In Rev. Rul. 79-121, the amount paid to the charitable organization was clearly payment for specific and identifiable services. Therefore, the ruling was correct in treating that amount as having been paid to the service provider and then transferred to the IRC 501(c)(3) organization. However, in Rev. Rul. 67-137, the amount paid to the IRC 501(c)(3) organization by designation of the employee is not payment for services by the employee. Furthermore, the employee received no economic benefit as a result of the payment to the IRC 501(c)(3) organization.

The facts and circumstances of the Charity/PAC matching program are more similar to the circumstances of Rev. Rul. 67-137 and Rev. Rul. 79-9 than to the circumstances of Rev. Rul. 79-121. The amount paid to the IRC 501(c)(3) organization designated by the employee is not a payment for

services performed by the employee. Furthermore, the employees do not receive either property or an economic benefit as a result of the contribution.

3. Is a corporation permitted to take a deduction under IRC 170 for amounts paid to an IRC 501(c)(3) organization pursuant to a Charity/PAC matching program?

No. IRC 170(a) provides that a deduction is allowed for any charitable contribution, payment of which is made within the taxable year. "Charitable contribution" is defined as a contribution or gift to or for the use of a charitable donee. It is settled that a transfer does not qualify as a contribution or gift unless it is made without receipt or expectation of a financial or economic benefit commensurate with the money or property transferred. See, e.g., Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Rul. 76-185, 1976-1 C.B. 60. This principle has been recently reaffirmed by the Supreme Court in two opinions, United States v. American Bar Endowment, 477 U.S. 105 (1986), and Hernandez v. Commissioner, 490 U.S. 680 (1989). In American Bar Endowment, the Supreme Court noted that, "[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return." 477 U.S. at 116. The Court applied a test in which a contribution was deductible (1) to the extent that the contribution exceeds the market value of the benefit received, and (2) if it was made with the intention of making a gift.

The same principle was applied in Hernandez. In Hernandez, the Court held that certain payments to the Church of Scientology were not eligible for a charitable deduction under IRC 170 because there was a quid pro quo for the claimed "contribution". In determining that a quid pro quo existed, the Court focused strongly on the external features of the transaction. The Court noted that looking at the external factors had the advantage of obviating the need to determine the motivations of individual taxpayers. The external factors indicating a quid pro quo included the existence of an identifiable benefit; fixed price schedules calibrated to sessions of particular length or sophistication; and the fact that the church barred the provision of benefits for free.

Applying this principle to the Charity/PAC matching program situation, the corporation making the payment to the IRC 501(c)(3) organization in return for payments to its affiliated PAC is not making a "contribution" or

"gift" within the meaning of IRC 170 because it receives a substantial benefit in return. A PAC is organized to promote the interests of its sponsor. A major role of a PAC is to make contributions to political candidates, which the corporate sponsor is prohibited by law from doing. Therefore, a contribution to a corporation's affiliated PAC is a benefit to that corporation. This benefit is received in return for the contribution the corporation agrees to make to the IRC 501(c)(3) organizations designated by the employee. Furthermore, as in Hernandez, the external features of the transaction also indicate the existence of a quid pro quo: there is an identifiable benefit, the benefit is fixed, and increases or decreases depending upon the amount of the contribution.

3. Political Organizations Under IRC 527

A. History of the Statute

Prior to 1975, there were no IRC provisions that dealt with the tax status of political organizations, such as political parties, campaign committees, and PACs. Rev. Proc. 68-19, 1968-1 C.B. 810, provided that political funds were generally not taxable income to the candidate on whose behalf they were collected, but it did not address the tax treatment of the political organization that collected the funds. However, as an administrative practice, the Service did not require political organizations to file returns and pay tax.

In Announcement 73-84, 1973-2 C.B. 461, the Service determined that since no IRC provisions provided for the tax-exempt status of political organizations, the investment income of political organizations, including interest, dividends, and capital gains, was subject to tax. The announcement stated that the Service would not enforce the taxation of political organizations until Congress had considered the problem. The content of Announcement 73-84 was restated in a reliance document, Rev. Rul. 74-21, 1974-1 C.B. 14, (modified and clarified in Rev. Rul. 74-475, 1974-2 C.B. 22), which provided that political organizations would be taxed on a prospective basis on their interest, dividends, and capital gains from sales of securities. Political organizations subject to tax were required to file Form 1120.

Congress' consideration resulted in the enactment of IRC 527 in 1975, effective for tax years beginning after December 31, 1974. This provision

provides for the taxation of political organizations. Political organizations are subject to tax on income other than contributions, dues, and fundraising income used for political campaign purposes. For all other purposes, they are considered tax-exempt organizations. IRC 527 also provides that a newsletter fund may qualify for the same tax treatment as a political organization if certain requirements are met. In addition, IRC 501(c) organizations that expend any money for political activity may be subject to tax under IRC 527. In 1981, IRC 527 was amended to provide more favorable tax treatment to the principal campaign committees of candidates for Congress and, in 1988, Congress further amended IRC 527 to provide that the exempt function of a political organization includes making expenditures relating to a public office if such expenditures would be allowable as a deduction under IRC 162(a) had the officeholder made the expenditure. The 1988 amendment is effective for tax years beginning after December 31, 1986.

B. Tax Treatment of Political Organizations Under IRC 527

1. What organizations are covered by the exemption and taxation provisions of IRC 527?

The provisions of IRC 527 apply only to "political organizations" as defined in IRC 527(e)(1). IRC 527(e)(1) provides that "the term 'political organization' means a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." ("Exempt function," a term that will be discussed in greater detail below, generally means, in the context of IRC 527, influencing or attempting to influence the selection, nomination, election or appointment of an individual to a federal, state, or local public office or office in a political organization. IRC 527(e)(2).)

2. What must a political committee, association, fund, or other organization do to be subject to federal income tax only as a political organization under IRC 527?

A political committee, association, fund, or other organization must meet both the organizational test of Reg. 1.527-2(a)(2) and the operational test of Reg. 1.527-2(a)(3) to be subject to tax only as a political organization under IRC 527.

To satisfy the organizational test, the organization must be organized for the primary purpose of carrying on exempt function activities as defined in IRC 527. The organization does not need to be formally chartered or established as a corporation, trust, or association. A separate bank account in which political campaign funds are deposited and disbursed only for political campaign expenses can qualify as a political organization. Rev. Rul. 79-11, 1979-1 C.B. 207. When there are no formal organizational documents, consideration is given to statements of the members of the organization at the time of its formation that they intend to operate the organization primarily to carry on exempt function activities. Reg. 1.527-2(a)(2).

To satisfy the operational test, the organization's primary activities must be exempt function activities as defined in IRC 527. The organization may engage in activities that are not exempt function activities, but these may not be its primary activities. Reg. 1.527-2(a)(3).

3. What are the practical steps that must be taken by a political organization?

A political organization must file a Form SS-4 to get an employer identification number ("EIN"), even if it does not have any employees. If it does not apply for its own EIN and uses the social security number or EIN of another person or organization (e.g., the candidate's social security number), then its income may be wrongly attributed to the other person or organization, generating adverse tax consequences with respect to that person or organization.

As noted above, a political organization does not need to have any formal organizational document, such as articles of incorporation, provided

there is a clear intention to establish a separate fund primarily for exempt function activity. It does not need to apply for recognition of its exemption from federal income tax, nor is it required to file information returns, such as the Form 990.

A political organization that has taxable income under IRC 527 must file a Form 1120-POL to report such income. IRC 6012(a)(6). The return is due on or before the 15th day of the third month after the close of the organization's fiscal year. IRC 6072(b). Some organizations that do not have taxable income during a tax year nevertheless file a Form 1120-POL in order to start the statute of limitations period running.

4. What is the tax treatment of a political organization under IRC 527, other than "principal campaign committees?"

Pursuant to IRC 527(a), a political organization is exempt from federal income tax except as provided in IRC 527. The tax imposed by IRC 527 on the political organization is calculated by multiplying the political organization taxable income by the highest rate of tax specified in IRC 11(b). IRC 527(b)(1).

If the political organization has net capital gain income, then its tax is the lesser of (1) the tax calculated under IRC 527(b)(1), or (2) the sum of the tax calculated under IRC 527(b)(1) on its non-capital gain income and the capital gains tax determined under IRC 1201(a). IRC 527(b)(2).

Principal campaign committees are discussed later in this article. Their tax is determined by applying the graduated rates of IRC 11(b) rather than the highest rate.

C. Exempt Function Activities of Political Organizations

1. What is the "exempt function" of a political organization?

IRC 527(e)(2) defines "exempt function" as "the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of

Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed."

Reg. 1.527-2(c)(1) uses the term "the selection process" to encapsulate what is contemplated by "exempt function." Promoting the nomination of an individual for an elective public office in a primary election, or in a meeting or caucus of a political party, also is an exempt function activity. Reg. 1.527-2(a)(1).[8]

For taxable years beginning after December 31, 1986, the exempt function of a political organization also includes making expenditures relating to a public office that would be allowable as a deduction under IRC 162(a) if incurred by the office holder. IRC 527(e)(2).

2. How does one determine whether an activity is part of an organization's "exempt function?"

To determine whether an activity is part of an IRC 527 organization's exempt function, one must examine all relevant facts and circumstances to determine the relationship between the activity and the statutory definition of "exempt function." The regulations divide exempt function activities (expenditures) into "directly related expenses" (Reg. 1.527-2(c)(1)) and "indirect expenses" (Reg. 1.527-2(c)(2)).

3. What are expenditures that are directly related to an individual's campaign for public office?

Generally, these expenditures include anything that supports the individual's campaign. It is not necessary for the individual to be an announced candidate for the office; whether he or she ever becomes a candidate is, in fact, not crucial. Reg. 1.527-2(c)(1). Therefore, travel, lodging, food and similar expenses of a candidate and the candidate's spouse for campaign-related travel are considered to be for an exempt function. Similarly, expenditures for attending a testimonial dinner to aid a campaign effort or expenditures

[8] In Announcement 88-114, 1988-37 I.R.B. 26, the Service proposed to characterize attempting to influence the confirmation of a federal judge as an exempt function activity for purposes of IRC 527(e)(2) and requested comments on the proposed position. (For background, see G.C.M. 39694 (Feb. 3, 1988).) No final determination of this issue has been made.

for voice and speech lessons to improve a candidate's skills are for an exempt function. Reg. 1.527-2(c)(5).

4. Do the activities need to be related to a particular candidate's or office holder's own campaign?

No. That activities need not seek to influence a particular candidate's or office holder's own campaign is illustrated by Rev. Rul. 79-12, 1979-1 C.B. 208. In that ruling, the payment of the expenses of an elected legislator to attend a political party's convention as a delegate by the legislator's campaign committee from a prior election is held to be an exempt function activity because it involves the selection process. Similarly, the payment of expenses for voter research, public opinion polls, and voter canvasses on behalf of a candidate is an exempt function activity, even when the funds expended were contributed to the organization in connection with the candidate's campaign for a different public office. Rev. Rul. 79-13, 1979-1 C.B. 208. Furthermore, expenditures for seminars and conferences that are intended to generate support for candidates with political philosophies in harmony with that of an IRC 527 organization are also for an exempt function. See Reg. 1.527-2(c)(5)(viii).

5. Can election night and post-election expenditures be related to the exempt function of the organization?

Yes. Expenditures for an election night party for political campaign workers are "an inherent part of, and the traditional public culmination of, the selection process;" therefore, these are exempt function expenditures. Rev. Rul. 87-119, 1987-2 C.B. 151, Q&A 1. Similarly, cash awards to campaign workers after an election are for an exempt function if the amount given each worker is reasonable, considering the exempt function services the worker rendered and the amount of other compensation, if any, already paid. Id. Q&A 2.

6. Can expenditures for activities between elections be related to the organization's exempt function?

Yes. Reg. 1.527-2(c)(5)(vii) exemplifies this position in stating that expenditures by an IRC 527 organization between elections to train staff members for the next election, draft party rules, implement party reform proposals, and sponsor a party convention are for an exempt function.

7. Are expenditures incurred in terminating the organization's activities considered to be exempt function expenditures?

An activity that is in furtherance of the process of terminating an IRC 527 organization's existence is an exempt function activity. Reg. 1.527-2(c)(3). For example, where an organization is established to further a single campaign, its post-campaign activities of paying campaign debts, winding up the campaign, and putting its records in order are for an exempt function.

8. Would a political organization's sponsorship of a nonpartisan educational workshop that is not intended to influence or attempt to influence the selection process be an exempt function activity?

No. The determinative factor here is that the organization is not attempting to affect any individual's selection. Reg. 1.527-(a)(3).

9. Is the making of expenditures to support or oppose a referendum or initiative measure an exempt function activity?

Generally, expenditures to support or oppose a referendum or initiative measure are not for an exempt function activity, since this activity generally does not further the purpose of influencing or attempting to influence the selection

process.[9] In a particular case, however, such expenditures may be for an exempt function activity, if the primary purpose of such expenditures is to influence or attempt to influence the selection process. For example, a legislative candidate's campaign committee may make expenditures to oppose a ballot initiative which would re-apportion legislative districts in a manner detrimental to the candidate's re-election effort; since such expenditures are made for the primary purpose of influencing or attempting to influence the individual's election to public office, they are for an exempt function activity.

In TAM 91-30-008 (April 16, 1991), a gubernatorial candidate's committee funded a direct mail campaign to promote a statewide nonbinding referendum on fiscal responsibility. The material prominently displayed the candidate's name and picture and identified him as a leader on the issue. However, it did not specifically mention his candidacy since, at the time the material was mailed, he had not announced his bid for governor. The TAM concludes that the expenditures were exempt function expenditures for purposes of IRC 527(e)(2), noting that (1) an activity possibly constituting grass roots lobbying for other IRC purposes does not preclude it from being treated as an IRC 527 exempt function expenditure, and (2) in this case, the mailing both disclosed the candidate's name, picture, and political philosophy to the public and identified him as a potential candidate for governor on the issue of fiscal responsibility.

10. What is the proper tax status for a ballot measure committee (an organization formed specifically to support or oppose an initiative or referendum measure)?

Expenditures to support or oppose initiatives, referenda, etc., generally are considered to be lobbying expenditures rather than political campaign activity. An IRC 501(c) organization may engage in lobbying activity, although there are limits on the amount of lobbying that an IRC 501(c)(3) organization may do.

[9] In addition to the fact that the statute refers to "selection, . . . of any individual" and the regulations refer to "the selection process", the legislative history treats ballot measure expenditures as outside the purview of exempt function activity. See S. Rep. No. 93-1357, 93d Cong. 2d Sess. 27 (1974), 1975-1 C.B. 517, 532, (stating, in discussing the primary activities test, that "a qualified organization could support the enactment or defeat of a ballot proposition, as well as support or oppose a candidate, if the latter activity was not its primary activity").

Consequently, a ballot measure committee cannot qualify to be treated under the provisions of either IRC 527 or IRC 501(c)(3), but may, in the appropriate case, qualify for tax exempt status under other subparagraphs of IRC 501(c), for example, IRC 501(c)(4), (5), or (6). Besides otherwise meeting the requirements of the relevant subparagraph of IRC 501(c), the organization must file an annual information return (Form 990).

The Service is attempting to develop an administrative procedure to expedite recognition of exempt status for organizations organized and operated solely to function as a ballot measure committee under laws administered by an elections commission or similar agency in a particular state that circumscribe the committee's functioning in a manner consistent with IRC 501(c)(4). If adopted, the procedure would make it easier for these essentially short-term organizations to satisfy the Service's need to have records regarding their existence.

11. What are expenditures that are indirectly related to the exempt function?

Expenditures that are necessary to support the directly related activities of a political organization are indirectly related to its exempt function. Examples of expenditures that are considered necessary to support the activities of a political organization are those attributable to overhead, record keeping, and fundraising. Reg. 1.527-2(c)(2).

In some cases, an organization that does not make any directly related expenditures can still qualify as a political organization under IRC 527. G.C.M. 39178 (Dec. 3, 1983), describes an organization that was formed by and controlled by a political organization for the purpose of constructing, owning, and operating a building to house the headquarters of the political organization. The G.C.M. concludes that the organization qualifies as a political organization because its expenditures were necessary to support the directly related activities of the controlling organization.

12. Could an organization organized and operated for the purpose of opposing an individual qualify as a political organization under IRC 527?

The word "influence" in IRC 527(e)(1) embraces both support and opposition. Therefore, an organization organized and operated to oppose an individual's nomination, selection, election, or appointment to public office, etc., may qualify as an IRC 527 political organization.

D. Taxable Income of Political Organizations, Their Exempt Function Income, and Expenditures That Result in Other Adverse Tax Consequences

1. What are the general rules used to determine whether income received by a political organization is taxable?

IRC 527(c)(1) defines "politi-cal organization taxable income" (or "taxable income") as an amount equal to the organi-zation's gross income (excluding exempt function income) over deductions directly allowed by the Code that are directly connected with producing gross income (excluding exempt function income), computed with the modifications provided in IRC 527(c)(2). (See D-7, below, for the definition of "exempt function income.")

IRC 527(c)(2) provides three modifications.

(A) A specific deduction of $100 is provided. ("Newsletter funds," however, may not take the $100 deduction. "Newsletter funds" are discussed later in this article.)

(B) No net operating loss deduction under IRC 172 is allowed.

(C) No deductions are allowed under part VIII of subchapter B of the Code (IRC 241-249), relating to special deductions for corporations.

Note that illegal expenditures and expenditures for non-exempt function activities that directly or indirectly benefit the political organization financially are also subject to tax and must be reported as political

organization taxable income on line 9 of Form 1120-POL. These two types of expenditures are discussed later in this article.

2. Is interest on state or local bonds, within the meaning of IRC 103, excluded in determining gross income under IRC 527(c)(1)?

Yes. The definition of gross income under IRC 61 and the exclusions from gross income thus defined apply in determining gross income under IRC 527(c)(1) also.

3. Under what circumstances are expenses, depreciation, and similar items deductible?

Reg. 1.527-4(c)(1) provides that expenses, depreciation, and similar items are deductible only if they satisfy both of the following requirements:

(A) They must qualify as deductions allowed under Chapter 1; and

(B) They must be "directly connected" with producing political organization taxable income.

To be "directly connected," a deduction item must have a proximate and primary relationship to producing taxable income and have been incurred in producing such income. Reg. 1.527-4(c)(2). If an item is attributable solely to producing taxable income, it is allowed under IRC 527. For example, Rev. Rul. 85-115, 1985-2 C.B. 172, holds that where state income taxes that a political organization paid on non-exempt function income were attributable solely to items of taxable income, they bore a "proximate and primary relationship" with producing that income. Since IRC 164 provides a deduction for such taxes in the year paid or accrued, they were allowed as a deduction under IRC 527(c)(1) in the year paid.

Whether the requisite relationship exists depends on all relevant facts and circumstances. (Compare the rules pertaining to computation of the unrelated business income tax, Reg. 1.512(a)-1(a) and (b).) The regulations

further provide that if an organization has a net capital loss, the rules of IRC 1211(a) and 1212(a) apply. Therefore, capital losses are allowed only to the extent of capital gains; furthermore, net capital losses may be carried back for three and forward for five years.

Where facilities or personnel are used both for exempt function and taxable purposes, deductions relating to that use must be allocated between exempt function and taxable income. Reg. 1.527-4(c)(3) requires that such an allocation be "on a reasonable and consistent basis." Time spent on exempt function and taxable activities is a permitted basis for allocating salaries of personnel, for example. (Compare the principles of allocation relating to dual use of facilities or personnel set forth in Reg. 1.512(a)-1(c).)

4. Are indirect expenses deductible?

No. The legislative history states: "Indirect expenses (such as general administrative expenses) are not to be allowed as deductions, since it is expected that these amounts will be relatively small and eliminating these deductions will greatly simplify tax calculations." S. Rep. No. 93-1374, 93d Cong., 2d Sess. 29 (1974), 1975-1 C.B. 517, 533.

5. Is a political organization (other than a newsletter fund) required to file Form 1120-POL if its gross income, after taking its directly connected deductions but before applying the specific $100 deduction, is no more than $100?

No. In explaining the specific $100 deduction, the Senate Finance Committee Report states: "As a result, a political organization is not subject to tax and is not required to file a return unless its gross income exceeds its directly connected deductions by more than $100." Id. However, some IRC 527 organizations file Form 1120-POL even when not required to start the statute of limitations period running.

6. What are the rules regarding assessment and collection of IRC 527 taxes?

Taxes imposed by IRC 527 are imposed under Subchapter A of the Code so all provisions of the Code and regulations that apply to Subchapter A taxes apply to assessment and collection of IRC 527 taxes. Therefore, political organizations subject to tax under IRC 527 are subject to the provisions, including penalties, for corporations generally. However, political organizations are not subject to the requirements of IRC 6655(g)(3) regarding estimated tax payments. See Reg. 1.527-8(a).

7. What is a political organization's "exempt function income?"

Receipts of a political organization must meet two requirements to be considered exempt function income. First, they must be amounts received by the political organization as (1) a contribution of money or other property; (2) membership dues, fees, or assessments from a member of the political organization; (3) proceeds from a political fundraising or entertainment event or from the sale of political campaign materials, which are not received in the ordinary course of any trade or business; or (4) proceeds from conducting bingo games that are defined in IRC 513(f)(2). IRC 527(c)(3). Thus, investment income, or income from a trade or business (such as renting excess office space to an unrelated organization), of a political organization is not exempt function income. Amounts received by a political organization in exchange for its promise to exercise political influence on the payor's behalf or in exchange for some other quid pro quo are likewise not exempt function income. Rev. Rul. 75-103, 1975-1 C.B. 17.

Second, receipts must be set aside in a segregated fund to be considered exempt function income. IRC 527(c)(3). A segregated fund is a fund established and maintained by a political organization or individual separate from other assets, the purpose of which is to receive and segregate exempt function income and earnings on such income, for use only for exempt function purposes. Reg. 1.527-2(b)(1).

8. What is the meaning of "contribution of money or other property?"

Under IRC 527(e)(3) and Reg. 1.527-3(b), "contribution" has the same meaning as that given in IRC 271(b)(2) (relating to political organization bad debts). IRC 271(b)(2) provides that the term includes a gift, subscription, loan, advance, or deposit of money or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not it is legally enforceable. Generally, therefore, money or other property, whether solicited personally, by mail, or through advertising, qualifies as a contribution. Additionally, funds received under a personal income tax return "checkoff" provision (IRC 9001-9042) or similar campaign financing provisions are treated as contributions.

The legislative history indicates that exempt function income may be received indirectly as well as directly. In discussing the qualification of political organizations, the Senate Finance Committee Report states: "An organization may qualify as a political organization if it indirectly receives or expends money for campaign purposes. For example, if a national organization receives political contributions directly through local organizations, it would be indirectly accepting contributions and would qualify under the bill." S. Rep. No. 93-1357, 93d Cong., 2nd Sess. 22 (1974), 1975-1 C.B. 517, 532 (emphasis supplied). The language of IRC 527(e)(1), in defining the "political organizations" with which IRC 527 is concerned, similarly indicates that indirect contributions are a permissible form of exempt function income. IRC 527(e)(1) defines the exempt purpose of a political organization as "directly or indirectly accepting contributions or making expenditures . . . for an exempt function" (emphasis supplied).

G.C.M. 39178 (March 6, 1984), relies on the above quoted passage from the Senate Report in concluding that an organization that constructed, owned, and operated a building to house the headquarters of the IRC 527 organizations that controlled it received "exempt function income" from sharing expenses of the buildings with the related organizations. Therefore, the payments from other IRC 527 organizations for shared expenses were indirect contributions to the organization.

9. What is the meaning of "membership dues, a membership fee or assessment from a member of a political organization?"

Reg. 1.527-3(c) provides that amounts denominated as "membership dues" or "fees" are not exempt function income if re-ceived in consideration for ser-vices, goods, or other items of value. However, filing fees that an individual pays directly or indirectly to a political party to run as a candidate in the party primary or in the general election as a party candidate, are exempt function income. For example, some states require certain office holders to pay a percentage of their first year's salary for the office to the state as a filing or "qualifying" fee or party assessment; the state then transfers the amount to the party. The transferred amount is exempt function income, as are amounts that the individual pays directly to the party as a filing fee. Id.

10. What is the meaning of "proceeds from political fundraising or entertainment events or sale of political campaign materials, which are not received in the ordinary course of any trade or business?"

To generate exempt function income, a fundraising event must be "political in nature" and "not carried on in the ordinary course of a trade or business." Reg. 1.527-3(d)(1). Whether an event is "political in nature" depends on all relevant facts and circum-stances. One factor to be con-sidered is the extent that the event is related to a political activity aside from the organization's need for income or funds. Originally, proposed regulations would have adopted a "substantially related" test similar to the test contained in IRC 513(a) and the applicable regulations. This approach was rejected in favor of the above formulation, providing that the relationship to political activity is only one relevant factor. See T.D. 7744, 1981-1 C.B. 360, 361.

Whether a fundraising event is carried on "in the ordinary course of a trade or business" depends on all relevant facts and circumstances. Reg. 1.527-3(d)(2). Relevant factors include the activity's frequency, the manner in which it is conducted, and the span of time over which it is carried out. (Compare Reg. 1.513-1(c)(1), which discusses when a trade or business is "regularly carried on" for purposes of applying the unrelated business income tax.) In general, proceeds from "casual, sporadic" fundraising are not received in the ordinary course of a trade or business.

Under IRC 527(c)(3)(C), proceeds from the sale of political campaign materials are exempt function income if the sale is not in the ordinary course of a trade or business (see Reg. 1.527-3(d)(2)), and is related to exempt function activity aside from the organizations need for income or funds. Reg. 1.527-3(e). Items sold may include political memorabilia, bumper stickers, buttons, hats, shirts, posters, stationery, jewelry, or cookbooks, where identified as relating to the distribution of political literature or organizing voters to vote for a candidate.

These provisions were applied in Rev. Rul. 80-103, 1980-1 C.B. 120, where a political organization sold reproductions of an original work of art, not of a political nature, that the artist had donated to it. The reproductions were sold over a period of several months through an art gallery, to which the organization had paid a fee. The sales were made solely for fundraising purposes; they were not related to the organi-zation's political activity aside from its need for funds. Nor, because of the length of the sale period, could the sales be characterized as "casual" and "sporadic." See Reg. 1.527-3(d)(2). Therefore, Rev. Rul. 80-103 holds that the proceeds were not exempt function income.

11. What is the tax effect to a political organization of using amounts from a "segregated fund" to make expenditures for non-exempt function activities?

During a tax year, if a political organization makes an insubstantial amount of expenditures from a segregated fund for non-exempt function activities, there are no income tax consequences to the organization. Reg. 1.527-2(b)(1). The only exceptions to this general rule are when the expendi-ture is illegal or for an illegal activity, or the expenditure directly or indirectly financially benefits the political organization. The regulations specifically provide for those two types of expenditures to be included in the gross income of the political organization, even when insubstantial in amount. Reg. 1.527-5(a). If non-exempt function expenditures in a tax year are more than insubstantial, however, the fund is not treated as a segregated fund for that year. Reg. 1.527-2(b)(1). If the fund is not treated as a segregated fund for a tax year, then all amounts set aside in that fund during such year are included in gross income with no ex-clusion available for exempt function income since the receipts were not properly segregated for the year. Thus, all amounts the political organi-zation receives during the year that it

placed in that fund, less available deductions, will constitute taxable income to it.

If an organization makes more than an insubstantial amount of expenditures for non-exempt function activities from a segregated fund in more than one year, the facts and circumstances may indicate that the fund was never a segregated fund. Reg. 1.527-2(b)(1). In that case, the exclusion from gross income for exempt function income would not be available for the political organization in prior years.

12. What amount of expenditures is more than insubstantial?

The Service has not developed a bright-line test for determining what is a more than insubstantial amount of non-exempt function expenditures. Law developed under the "no substantial part" test that pertains to lobbying by charitable organizations provides some guidance, however.

One frequently cited decision held that lobbying activities constitut-ing five percent of total activities of an organization were not substan-tial. Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955). In Haswell v. United States, 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), the court held that lobbying activities constituting between 16.6 percent and 20.5 percent of total expenditures were substantial. (The figures varied with the years involved and the method of calculation.)

13. Would the fact that a segregated fund was no longer treated as such because of substantial non-exempt function expenditures necessarily affect the status of the political organization as an organization described in IRC 527(c)? If not, what would cause the political organization not to be so described?

As noted above, IRC 527(e)(1) defines a political organization as being orga-nized and operated primari-ly for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt func-tion, and Reg. 1.527-2(a)(3) provides that a political organization may engage in non-exempt function activity, provided the activity is not primary. Therefore, the demise of a political organization's segregated fund because of substantial non-exempt function

expenditures would not necessarily have an adverse tax effect on any other segregated funds maintained by the political organization or on the political organization's status under IRC 527 (assuming it had income in other segregated funds), so long as, after taking all facts and circumstances into account, the political organization's exempt function activities were primary. If the political organization's non-exempt function activities were primary, however, it would lose its tax status under IRC 527.

14. How is an organization taxed that loses its exempt status under IRC 527?

An organization that loses its exempt status under IRC 527 is subject to federal income tax under general tax principles. Depending on the organization's structure, it may be subject to tax as a corporation (see Rev. Rul. 74-21, 1974-1 C.B. 14), or as a trust (see Rev. Rul. 74-23, 1974-1 C.B. 17). Amounts received as political campaign funds and used for political campaign purposes will not be included in its gross income. However, the organization will be subject to tax on other income it receives, and on its diversions of campaign funds that financially benefit the organization or that are for illegal expenditures. Also, since the organization is not organized and operated primarily for political campaign purposes, exemption from federal income tax may be available under IRC 501 (but not under IRC 501(c)(3)), if applicable requirements are met.

15. What is the tax effect to a political organization of using amounts in its "segregated fund" to make expenditures that are illegal or for an activity that is judicially determined to be illegal?

Expenditures that are illegal, or for an activity that is judicially determined to be illegal, are never considered to be for exempt function activities. Reg. 1.527-2(c)(4). Thus, if such expenditures are more than insubstantial, the fund will not be considered a segregated fund for the taxable year. In addition, the amount of such expenditures is included in the political organization's taxable income for the year in which they are made, even where the amount of the organization's expenditures for non-exempt function activities is not substantial (so as to cause all receipts of that segregated fund during relevant periods not to be exempt function income). Reg. 1.527-5(a)(2). However, amounts will not be included in political organization taxable income more than once (that is, because they

were not properly segregated and because they were expended illegally or for an illegal activity). The prohibition on illegal expenditures is intended to apply to criminal activities and not to violations of civil law, regulation, or administrative rule.

It should be noted Reg. 1.527-5(a)(2) specifically provides that expenses incurred in defense of suits against the political organization are not treated as taxable income to it. Similarly, voluntary reimbursement to the participants in the (alleged) illegal activity for similar expenses incurred by them are not taxable to the organization if it can demonstrate that such payments do not constitute a part of the inducement to engage in the illegal activity or part of the agreed upon compensation therefor. However, if the organization entered into an agreement with the participants to defray such expenses as part of the inducement, such payments would be treated as an expenditure for an illegal activity.

16. What is the tax effect to a political organization of using amounts in its "segregated fund" to make expenditures for non-exempt function activities that directly or indirectly benefit the political organization financially?

Expenditures for non-exempt function activities that directly or indirectly financially benefit a political organization (for exam-ple, the purchase of an office building for the production of income), will result in the fund not being considered a segregated fund for the taxable year if such expenditures are more than insubstantial. In addition, the amount of such expenditures is included in the political organization's taxable income for the year in which they are made, even where the amount of the organization's expenditures for non-exempt function activities is not substantial (so as to cause all amounts received during relevant periods not to be exempt function income). Reg. 1.527-5(a)(1). Amounts will not be included in political organization taxable income more than once, however (that is, because they were not properly segregated and because they were expended for an activity financially benefiting the organization).

Reg. 1.527-5(a)(1) contains specific examples of when a political organization's expenditures on facilities or equipment will and will not be included in its taxable income. It provides that if the organization expends exempt function income for making an improvement or addition to its

facilities, or for equipment, that is not necessary for or used in carrying out an exempt function, the amount of the expenditure will be included in the political organization's taxable income. It proceeds to state, however, that if a political organization expends exempt function income to make ordinary and necessary repairs on the facilities it uses in conducting its exempt function, such amounts will not be included in its taxable income.

17. How are loans made by a political organization treated?

Loans made by a political organization are "expenditures" of the organization. IRC 217(b)(3). The treatment of a particular loan depends on whether it is for an exempt function activity.

18. Are transfers to other organizations allowable?

Yes. IRC 527(d) specifies certain situations where a political organization's transfers to other organizations are not treated as amounts expended for the personal use of the candidate or any other person; instead, they are treated as exempt function expenditures. The allowable transfers are as follows:

(A) Contributions to or for the use of another IRC 527 political organization or newsletter fund;

(B) Contributions to or for the use of any tax-exempt public charity that is described in IRC 509(a)(1) or (2); and

(C) Deposits made to the general fund of the Treasury or the general fund of any State or local government.

IRC 527(d) specifically provides, however, that no deduction will be allowed for transferred amounts. See also Reg. 1.527-5(b). Furthermore, this provision does not apply to any amount transferred in satisfaction of a liability of the candidate or other person. For example, an amount paid to the general fund of the U.S. Treasury in satisfaction of the candidate's tax liability will be included in the candidate's gross income and is not an exempt function expenditure. Reg. 1.527-5(a)(1).

19. Under what circumstances will an individual receive gross income as a result of expenditures of amounts in its segregated fund by a political organization?

As indicated in the response to the previous question, the general principle here is that amounts expended by the political organization for an exempt function, as defined in IRC 527(e)(2), are not income to the individual on whose behalf such expenditures are made. Thus, for example, a political organization may reimburse an individual's actual expenses for travel to political fundraising events; such amounts are expenditures for an exempt function and therefore are not income to the individual. Reg. 1.527-2(c)(5)(i) and 5(a)(1).

The opposite result is reached, however, where a political organization makes expenditures for non-exempt function activities, using amounts in its segregated fund, to an individual for his or her personal use. In that case, the individual on whose behalf the expenditures are made will be in receipt of income, in the amount of the expenditure, for the taxable year in which the amount is received.

20. What determines whether a payment is made for "personal use?"

Reg. 1.527-5(a)(1) provides that amounts are expended for the personal use of an individual where a direct or indirect financial benefit accrues to such individual. "Personal use" is not limited to direct financial benefit, but includes (for example) the benefit an individual derives from directing funds to a third party. See Estate of Geiger v. Commissioner, 352 F.2d 221 (8th Cir. 1965).

Note that whether an individual benefiting from such expenditures receives taxable income depends on general income tax principles, that is, whether such amounts are includable in the individual's gross income pursuant to IRC 61 and whether an exclusion (for example, as a gift under IRC 102), is available for such amounts.

Reg. 1.527-5(c)(1) provides that excess campaign funds are treated as expended for the personal use of the person having control of the ultimate

21. How are excess campaign funds -- funds controlled by a political organization or other person after a campaign -- treated?

use of the funds except to the extent that they are -

(A) Transferred within a reasonable period of time in accordance with IRC 527(d) (contributed to or for the use of another IRC 527 political organization or newsletter fund; contributed to or for the use of an IRC 509(a)(1) or (2) public charity; or deposited in the general fund of the U.S. Treasury or in the general fund of a State or local government); or

(B) Held in reasonable anticipation of use by the political organization for future exempt functions.

Therefore, a political organization's expenditure of excess campaign funds from one campaign to pay expenses of the candidate's campaign for a second office are for an exempt function and do not result in income to the candidate. Rev. Rul. 79-13, 1979-1 C.B. 208. Similarly, an elected legislator may expend surplus campaign funds to defray expenses of attending a political convention, an exempt function activity, without receiving taxable income. Rev. Rul. 79-12, 1979-1 C.B. 208.

Reg. 1.527-5(c)(2) provides that if the individual controlling the funds dies, the income will be included as part of the decedent's gross estate unless the funds are transferred to the organizations or funds described above within a reasonable period of time or unless the decedent provided for such a transfer.

22. What is a "reasonable period of time for transfer of excess campaign funds" or "reasonable anticipation of use for future exempt functions?"

The determination of what is a reasonable period of time for transfer of excess campaign funds or reasonable anticipation of use for future exempt functions is based on the facts and circumstances of the particular situation. Some of the facts and circumstances to be considered are (1) whether there are outstanding expenses remaining from the previous election, (2) whether the candidate has announced an intention to seek election in the future, and (3) the uses to which the excess campaign funds are currently being put. For example, a reasonable period of time for a campaign committee to retain excess campaign funds used to service a debt to an unrelated third party would be the period of debt service. Similarly, a reasonable anticipation of use for future exempt functions exists when the candidate has announced an intention to seek reelection. On the other hand, excess campaign funds that are unreasonably retained when there are no outstanding debts from a previous election and the candidate has announced an intention not to seek election to public office will be treated as expended for the personal use of the person having control of the ultimate use of the funds. Reg. 1.527-5(c)(1).

23. What is the tax effect to a political organization of using funds, other than segregated funds, to make expenditures for non-exempt function activities?

Non-segregated funds are included in the organization's taxable income when received. IRC 527(c)(1). The only additional tax effect resulting from making an expenditure of non-segregated funds may be a deduction from taxable income (where a deduction is available under IRC 527(c)).

E. Special Rules for Principal Campaign Committees

1. For purposes of IRC 527, what is a "principal campaign committee?"

For purposes of IRC 527, a "principal campaign committee" is the political campaign committee designated by a candidate for Congress as the candidate's principal campaign committee for purposes of section 302(e) of the Federal Election Campaign Act (2 U.S.C. sec. 432(e)). IRC 527(h)(2)(A). Therefore, principal campaign committees of candidates for public offices other than those in the United States Congress cannot qualify for treatment as a "principal campaign committee" under IRC 527.

2. What are the rules relating to designation of a princi-pal campaign committee for purposes of IRC 527?

A candidate for Congress may only designate one committee as a principal campaign committee at any time and, unless the candidate has only one campaign committee, must make the designation in the manner specified in the regulations. IRC 527(h)(2)(B). No political committee may be designated as the principal campaign committee of more than one candidate for Congress and no committee that supports or has supported more than one candidate for Congress may be designated as a principal campaign committee. Reg. 1.527-9(a).

Designation is made by attaching a statement to the committee's Form 1120-POL in each year the designation is desired. The statement must contain the name, address, and taxpayer identification number of the candidate and of the committee. Reg. 1.527-9(b). Revocation of the designation may be made only with the consent of the Commissioner in accordance with the procedures outlined in Reg. 1.527-9(c).

3. What is the tax treatment of a principal campaign committee?

The political organization taxable income of a principal campaign committee is taxed at the graduated rates under IRC 11(b) rather than the highest rate

specified in IRC 11(b). IRC 527(h)(1).

4. Does a political organization continue to qualify as a principal campaign committee under IRC 527 (h) when it makes contributions to campaign committees of other political candidates?

As noted above, a campaign committee will not qualify as a principal campaign committee if it supports more than one candidate for Congress. Reg. 1.527-9(a). This requirement in the regulations refers to and adopts the requirements of the regulations under FECA. Those regulations provide that support does not include contributions by an authorized campaign committee to an authorized campaign committee of another candidate that aggregate $1,000 or less per election. 11 C.F.R. 102.12(c). Therefore, a political organization will not qualify as a principal campaign committee if it contributes more than $1,000 per election to another candidate for Congress. However, if the committee's contributions to another Congressional candidate aggregate $1,000 or less per election, then it will continue to qualify as a principal campaign committee under IRC 527(h).

For purposes of construing the phrase "amounts aggregating $1,000 or less per election," primary and general elections are considered separate elections. Therefore, where a principal campaign committee contributed $2,000 to the authorized committee of a candidate for Congress, but designated $1,000 for the candidate's primary election and $1,000 for the general election, the contribution did not disqualify the committee from treatment as a principal campaign committee under IRC 527(h) because the $1,000 limit per election was not exceeded. TAM 92-24-002 (Feb. 19, 1992).

Because the requirements of IRC 527(h) are imposed by reference to FEC rules and because those rules only concern federal elections, there is no limitation imposed upon the amount of contributions a principal campaign committee may make to candidates for nonfederal offices or the number of nonfederal candidates it may support. This point is also covered in TAM 92-24-002, which concludes that a principal campaign committee's contributions of $3,000 to the campaign committee of a local judge and $2,000 to the committee of a mayoral candidate had no effect upon its status as a principal campaign committee under IRC 527(h).

5. What are the tax ramifications if a political organization no longer qualifies as a principal campaign committee under IRC 527 (h) because it supports more than one candidate for Congress?

An organization that does not qualify as a principal campaign committee under IRC 527(h) solely because it supports more than one candidate for Congress, but otherwise meets the requirements for a political organization, will continue to qualify as a political organization. Contributions to another political organization are exempt function expenditures. Therefore, the political organization taxable income would be taxed at the highest rate specified in IRC 11(b) rather than at the graduated rates. IRC 527(b).

6. Does a political organization continue to qualify as a principal campaign committee under IRC 527 (h) when its candidate is not seeking reelection to a Congressional office?

A principal campaign committee is not required to termi-nate immediately following an election. It may remain in existence for a reasonable period of time in order to wind up the affairs of the campaign without losing its status as a political organization. Similarly, a can-didate may have the political campaign committee continue in existence between election cycles for use in a reelection effort. During those periods, the political organization will continue to qualify as a principal campaign committee under IRC 527(h). However, once a candidate indicates an intention not to seek reelection, the political campaign committee may retain its status as a principal campaign committee only for the period of time reasonably necessary to wind up the affairs of the campaign. If the committee remains in existence longer than is reasonably necessary, or is converted to another use, then its status as a principal campaign committee will be terminated, even if it still qualifies as a political organization. The determination of whether the committee has remained in existence longer than reasonably necessary or has been converted to another use is based on the facts and circumstances of the situation. Some factors to be considered are whether the candidate has taken any steps towards seeking election for a different office, whether the political expenditures of the committee are primarily in support of the candidate's campaign activities

(either past or future), and whether the committee makes substantial non-political expenditures.

F. Special Rules for Newsletter Funds

1. What must a newsletter fund do to be subject to federal income tax only as a political organization under IRC 527?

To be subject to income tax only as a political organization under IRC 527, a newsletter fund must be described in IRC 527(g). (To the extent newsletter fund expenses are deductible by a public office holder under IRC 162(a), the fund may also satisfy the requirements to be a political organization as described in IRC 527(e)(1). In that case, the rules regarding political organizations generally apply in determining the organization's tax treatment, and not the rules regarding newspaper funds.)

To be described in IRC 527(g), a fund must meet three requirements. First, it must be established and maintained by an individual who holds, has been elected to, or is a candidate for nomination or election to, any federal, state, or local elective public office. Second, the fund must be established for use by such individual exclusively to prepare and circulate the individual's newsletter (the "organizational test"). Third, the fund must be maintained for use by such individual exclusively to prepare and circulate the individual's newsletter (the "operational test"). IRC 527(g)(1); Reg. 1.527-7(a).

Newsletter funds are subject to the same rules regarding taxable income as other IRC 527 organizations, except that they are not allowed to take the specific $100 deduction. Therefore, if a newsletter fund has any political organization taxable income, it must file Form 1120-POL.

2. Must a newsletter fund maintain a "segregated fund?"

All amounts received by a newsletter fund (and income thereon) must be segregated for use for the newsletter fund's exempt function. If amounts are not properly segregated, the fund is not described in IRC 527(g). Unlike political organizations generally, which must be organized and operated primarily for their exempt pur-pose,

newsletter funds must be used exclusively for the preparation and circulation of the newsletter. Compare IRC 527(e)(1) to IRC 527(g)(1).

3. What is the exempt function of a newsletter fund?

The exempt function of a newsletter fund consists solely of preparing and circulating the newsletter. IRC 527(g)(2)(A); Reg. 1.527-7(c). Consequently, its expenditures must be characterizable as preparation and circulation expenditures, for example, expenditures for secretarial services, printing, addressing, and mailing. Campaign activities that are not attributable to the preparation and circulation of the candidate's newsletter are not exempt function activities of a newsletter fund. IRC 527(g)(2); Reg. 1.527-7(c).

4. May the assets of a newsletter fund be used for campaign activities?

No. Reg. 1.527-7(d) provides that the exempt function of a newsletter fund does not include the following items:

(A) Expenditures for an exempt function as defined in Reg. 1.527-2(c); or

(B) Transfers of unexpended amounts to a political organization described in IRC 527(e)(1).

5. What are the rules relating to excess funds held by a newsletter fund that has ceased to engage in the preparation and circula-tion of the newsletter?

Reg. 1.527-7(e) provides that excess newsletter funds are treated as expended for the personal use of the person who has established and maintained the fund, except to the extent that they are within a reasonable period of time -

(A) Contributed to another IRC 527(g) newsletter fund;

(B) Contributed to or for the use of an IRC 509(a)(1) or (2) public charity; or

(C) Deposited in the general fund of the U.S. Treasury or in the general fund of a State or local government.

6. What is the tax effect to a newsletter fund of making expenditures for non-exempt function activities?

If a newsletter fund makes any expenditures for non-exempt function activities (including political activities that are exempt function activities for other political organizations), it is no longer exclusively operated for the purposes set forth in IRC 527(g) and, consequently, it loses its exempt status as an organization described in that subparagraph. See also Reg. 1.527-7(a) and (c).

Generally, loss of exempt status will operate prospectively, and the newsletter fund will be taxed pursuant to IRC 527 for prior periods. However, where a newsletter fund makes expenditures for non-exempt function activities, the facts and circumstances may indicate the fund was never established and maintained exclusively for an exempt function. In that case, loss of exempt status will operate retroactively, and the newsletter fund will not be taxed pursuant to IRC 527 for prior periods. Reg. 1.527-7(a).

7. What is the tax effect of a newsletter fund losing its exempt status as an organization described in IRC 527(g)?

If a newsletter fund loses its exempt status as an organization described in IRC 527(g), the individual who established and maintains the fund will be held to be in receipt of income in the amount of any expenditures made by the fund for non-exempt function activities during the period prior to loss of exempt status. In addition, future contributions to the fund will constitute income to such individual. If loss of exempt status operates retroactively, past contributions may also constitute income to such individual, for the periods in which received by the fund. Reg. 1.527-7(a). See Rev. Rul. 73-356, 1973-2 C.B. 31 (concerning tax treatment of non-exempt newsletter funds).

G. Political Organizations and IRC 6113

1. What are the general requirements of IRC 6113 for political organizations?

IRC 6113 requires IRC 527 political organizations (as well as IRC 501(c) organizations that are ineligible to receive tax deductible charitable contributions) to disclose in "an express statement (in a conspicuous and easily recognizable format)," the nondeductibility of contributions during fundraising solicitations. A fundraising solicitation is any solicitation of contributions or gifts that is made in written form, by television or radio, or by telephone, but does not include any letter or telephone call that is not part of a coordinated fundraising campaign soliciting more than 10 persons during the calendar year. This requirement does not apply to political organizations that normally do not have gross receipts in excess of $100,000 during a tax year, although two or more organizations may be treated as one organization where necessary to prevent the avoidance of this provision through the use of multiple organizations.

Notice 88-120, 1988-2 C.B. 454, provides detailed guidance, including safe harbors, on the application of IRC 6113. The following questions and answers are based upon Notice 88-120.

2. What are examples of solicitations that must contain the IRC 6113 disclosure statement?

A political organization's solicitations for all voluntary contributions as well as solicitations for attendance at testimonials and other fundraising events must include the disclosure statement. For example, solicitations by a political organization for contributions to a Congressional campaign committee must include the disclosure statement. Solicitations for memberships and annual dues, as well as solicitations for membership and dues renewals, are also subject to the requirements of IRC 6113.

3. What are examples of situations that do not require the IRC 6113 disclosure statement?

Situations where a political organization is not required to make the IRC 6113 disclosure statement include billing adver-tisers in its publications and billing attendees at a conference it conducts (as distinguished from a testimonial or fundraising event). General material discussing a political candidacy and requesting persons to vote for the candidate or "support" the candidate need not include the disclosure statement unless the material specifically requests either a financial contribution or a contribution of volunteer services on behalf of the candidate.

4. How does the Service determine whether an organization has annual gross receipts that do not normally exceed $100,000?

In determining whether an organization has annual gross receipts that do not normally exceed $100,000, the Service will generally follow the principles set forth in Reg. 1.6033-2(g) and Rev. Proc. 83-23, 1983-1 C.B. 687, which provide rules for determining annual gross receipts with respect to the similar exception from the filing of annual information returns for small organizations. In general, these rules set out a three year average as the basic rule. The organization must include the required disclosure statement on all solicitations made more than 30 days after reaching $300,000 in gross receipts for the three year period of the calculation. For example, if on July 1 of the third year of a calculation (for an organization with a calendar year accounting period) the organization reaches $300,000 in total gross receipts for the prior two years and the first six months of the third year, it must include the required disclosure statement on all solicitations no later than August 1. A local, regional, or state chapter of an organization with gross receipts under $100,000 must include the disclosure statement in its solicitations if at least 25 percent of the money solicited will go to the national, or other, unit of the organization that has annual gross receipts that exceed $100,000 because the solicitation is considered as being in part on behalf of such unit of the organization.[10]

[10] Also, if a trade association or labor union with over $100,000 in annual gross receipts solicits funds that will pass through a PAC with less than $100,000 in gross receipts, the solicitation must contain the required disclosure statement.

5. What would be a print medium format that would satisfy the IRC 6113 disclosure statement requirement?

In the case of a solicitation by mail, leaflet, or advertisement, the following four requirements should be met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;"

(B) The statement is in at least the same size type as the primary message stated in the body of the letter, leaflet, or ad;

(C) The statement is included on the message side of any card or tear-off section that the contributor returns with the contribution; and

(D) The statement is in the first sentence in a paragraph or itself constitutes a paragraph.

6. What would be a telephone solicitation format that would satisfy the IRC 6113 disclosure statement requirement?

In the case of a solicitation by telephone, the following three requirements should be met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organiza-tion] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;"

(B) The statement is made in close proximity to the request for contributions, during the telephone call, by the telephone solicitor; and

(C) Any written confirmation or billing sent to a person pledging to contribute during the telephone solicitation complies with the requirements for print medium solicitations set forth above.

7. What would be a television solicitation format that would satisfy the IRC 6113 disclosure statement requirement?

In the case of a solicitation by television, the following two requirements should be met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contri-butions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization] are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;" and

(B) If the statement is spoken, it is in close proximity to the request for contributions; if the statement appears on the television screen, it is in large, easily readable type appearing on the screen for at least five seconds.

8. What would be a radio solicitation format that would satisfy the IRC 6113 disclosure statement requirement?

In the case of a solicitation by radio, the following two requirements should be met:

(A) The solicitation includes whichever of the following statements the organization deems appropriate: "Contributions or gifts to [name of organization] are not deductible as charitable contributions for Federal income tax purposes," "Contributions or gifts to [name of organization]

are not tax deductible," or "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions;" and

(B) The statement is made in close proximity to the request for contributions during the same radio solicitation announcement.

9. What does the Service do if a political organization makes a fundraising solicitation to which IRC 6113 applies and does not follow the formats set forth above?

If a political organization makes a solicitation to which IRC 6113 applies, and the solicitation does not comply with the formats set forth above, the Service will evaluate all the facts and circumstances to determine whether the solicitation contained "an express statement (in a conspicuous and easily recognizable format) that contributions and gifts are not deductible for Federal income tax purposes." IRC 6113(a). A good faith effort to comply with the requirements of IRC 6113 will be an important factor in the evaluation of the facts and circumstances. However, disclosure statements made in the fine print will not be considered to be in compliance with the statutory requirement.

10. What are the penalties for failure to comply with the requirements ofIRC 6113?

The failure to include the required disclosure of the non-deductibility of contributions in fundraising solicitations to which IRC 6113 applies results in a penalty of $1,000 for each day on which such a failure occurs, up to a maximum penalty of $10,000. IRC 6710(a). No penalty will be imposed if the failure is due to reasonable cause. IRC 6710(b). In cases where the failure to make the required disclosure is due to intentional disregard of the law, the $10,000 per year limitation on the penalty does not apply and more severe penalties based on up to 50 percent of the aggregate cost of the solicitations are applicable. IRC 6710(c). For purposes of determining the penalty, "each day on which a failure occurs" means the day that a solicitation is mailed, distributed, published, telecast, broadcast, or spoken by telephone. IRC 6710(d). For example, if an organization mails 500 noncomplying solicitations on March 30 and 50 noncomplying solicitations

on April 5, the penalty would be $2,000, so long as the violation did not involve intentional disregard of the disclosure requirement.

4. Political Activities of IRC 501(c) Organizations

A. IRC 501(c) Organizations and IRC 527 Exempt Function Activities

1. May IRC 501(c) organizations make expenditures for "exempt function" activities?

An IRC 501(c) organization may make expenditures for exempt function activities as defined in IRC 527 to the extent consistent with its exempt status. As discussed above, an IRC 501(c)(3) organization is expressly prohibited from participating or intervening in any political campaign on behalf of or in opposition to any candidate for elective public office. Some other IRC 501(c) organizations are precluded from political activities because the subparagraph in which they are described limits them to an exclusive purpose (for example, IRC 501(c)(2) title holding companies, IRC 501(c)(20) group legal services plans). Other IRC 501(c) organizations are not similarly prohibited from engaging in political activities. An IRC 501(c) organization may generally make expenditures for political activities if such activities (and other activities not furthering its exempt purposes) do not constitute the organization's primary activity. Some of the IRC 501(c) organizations that have been held to be able to engage in political activities to varying degrees are social welfare organizations described in IRC 501(c)(4) (Rev. Rul. 81-95, 1981-1 C.B. 332 -- because organization's primary activities promote social welfare, its less than primary participation in political campaigns will not adversely affect its exempt status); labor organizations described in IRC 501(c)(5) (Marker v. Schultz, 485 F.2d 1003 (D.C. Cir. 1973) and G.C.M. 36286 (May 22, 1975)); business leagues described in IRC 501(c)(6) (G.C.M. 34233 (Dec. 3, 1969)); and fraternal beneficiary societies described in IRC 501(c)(8) (PLR 83-42-100 (July 20, 1983)).

2. What effect does political activity by an IRC 501(c) organization have on the deductibility of dues or contributions to the organization?

Generally, amounts paid to IRC 501(c) organizations other than IRC 501(c)(3) organizations are not deductible as charitable contributions. Nevertheless, in some instances, dues or contributions to such organizations may be deductible as business expenses under IRC 162. However, amounts paid for intervention or participation in any political campaign may not be deducted as a business expense. IRC 162(e)(2)(A). Therefore, any amounts paid to an IRC 501(c) organization that are specifically for political activities would not be deductible under IRC 162. Furthermore, if a substantial part of the activities of the IRC 501(c) organization consists of political activities, a deduction under IRC 162 is allowed only for the portion of dues or other payments to the organization that the taxpayer can clearly establish was not for political activities. Reg. 1.162-20(c)(3). While IRC 6113 requires IRC 501(c) organizations to disclose that payments of dues or contributions to them are not deductible as charitable contributions, IRC 6113 does not require IRC 501(c) organizations to disclose that part or all of the payments of dues or contributions to them are not deductible as business expenses because they constitute amounts paid for participation or intervention in a political campaign.

B. Tax on Political Expenditures - IRC 527(f)

1. What is the tax treatment to an IRC 501(c) organization of making expenditures for political activities?

Except for expenditures made from a separate segregated fund under IRC 527 (f)(3), an IRC 501(c) organization that makes expendi-tures for exempt function activities is subject to tax under IRC 527(b). IRC 527 (f)(1) provides that the tax base is an amount equal to the lesser of (1) the organization's net investment income for the taxable year in which such expenditures are made, or (2) the aggregate amount of expenditures for exempt function activities during the year. This treatment applies whether the IRC 501(c) organization makes such expenditures directly, or through another

organization. Thus, an IRC 501(c) organization may not avoid taxation under IRC 527(f)(1) by establishing a separate organization to make expenditures for exempt function activities, except as provided in IRC 527(f)(3).

2. What is included in the net investment income of an IRC 501(c) organization, that may become subject to tax under IRC 527(f)(1)?

IRC 527(f)(2) defines net investment income as the excess of (a) the gross amount of income from interest, dividends, rents, and royalties, plus the excess (if any) of gains from the sale or exchange of assets over the losses from the sale or exchange of assets, over (b) allowable deductions which are directly connection with producing such income. Income and expenses taken into account for purposes of the unrelated business income tax under IRC 511 are not taken into account in calculating net investment income for purposes of IRC 527(f)(2).

3. Is interest on state or local bonds, within the meaning of IRC 103, excluded in determining net investment income under IRC 527(f)(2)?

Interest on state or local bonds, within the meaning of IRC 103, should be excluded in determining net investment income under IRC 527(f)(2). In determining the gross amount of income from interest, etc., the definition of gross income under IRC 61 and the exclusions from gross income thus defined apply. Expenses directly connected with the production of interest on state or local bonds may not be deducted in determining net investment income.

4. What is deductible in determining net investment income?

Deductions allowed in determining net investment income under IRC 527(f)(2) must meet the same requirements as deductions allowed under IRC 527(c)(1). Expenses, deprecia-tion, and similar items must qualify as deductions allowed under Chapter 1 and must be directly connected with the production of the gross amount of income which is subject to tax. Reg. 1.527-4(c)(1).

Directly connected deductions have a proximate and primary relationship to the production of the taxable income and are incurred in the production of such income. The determination of whether a deduction was incurred in the production of taxable income is made on the basis of the relevant facts and circumstances. An item attributable solely to items of taxable income is proximately and primarily related to such income. Reg. 1.527-4(c)(2). For example, state income taxes paid on net investment income are attributed solely to items of taxable income and thus have a proximate and primary relationship with producing that income. Since IRC 164 allows a deduction for such taxes, they are deductible in computing net investment income under IRC 527(f). See Rev. Rul. 85-115, 1985-2 C.B. 172. The legislative history indicates that indirect expenses (such as general administrative expenses) are not allowed as deductions as these amounts were expected to be relatively small so that eliminating them would simplify the tax calculation. S. Rep. No. 93-1357, 93d Cong., 2d Sess. 29 (1974), 1975-1 C.B. 527, 533. The modifications under IRC 527(c)(2) also apply in computing the tax under IRC 527(f)(1). Reg. 1.527-6(d).

5. Are all expenditures that are considered exempt function expenditures for political organizations identically treated when carried on by an IRC 501 (c) organization?

No. Reg. 1.527-6(b)(4) and (5) provide two specific excep-tions. Under Reg. 1.527-6(b)(4), where an IRC 501(c) organization appears before any legislative body for the purpose of influencing the appointment or confirmation of an individual to a public office, any expenditure relating to such appearance is not treated as an exempt function expenditure.[11] The exception provided by Reg. 1.527-6(b)(5) relates to expenditures for nonpartisan activities (including nonpartisan voter registration and "get-out-the-vote" campaigns). To come within the exception, nonpartisan voter registration and "get-out-the-vote" campaigns must not be specifically identified by the organization with any candidate or political party.

[11] This exception is similar to, but more limited than, the "furnishing technical advice or assistance" exception relating to lobbying by IRC 501(c)(3) organizations under IRC 4911 and 4945. The exception contained in Reg. 1.527-6(b)(4) only concerns certain requested appearances before legislative bodies, whereas "technical advice or assistance" may be given otherwise than by appearance. Furthermore, the exception under Reg. 1.527-6(b)(4) only applies to appearances relating to appointments and confirmations, while the subject matter of the "technical advice or assistance" exception is unlimited.

6. Are an IRC 501(c) organization's expenditures allowed by FECA (2 U.S.C. sec.441b(b)(2)(C)) and its indirect expenses relating to political campaign activity considered exempt function expenditures?

Both issues are unresolved. With respect to the FECA issue, the statute specifically permits labor unions and trade associations to spend money for (1) internal communications with members, stockholders, and their families (but not to the general public) that might involve support of particular candidates; (2) the conduct of nonpartisan registration and get-out-the-vote campaigns aimed at their members, stockholders, and families; and (3) the establishment, administration, and solicitation of contributions to separate segregated funds to be used for political purposes. As a result, when the regulations under IRC 527 were published in proposed form, several commentators suggested that these expenditures, which are made routinely by some IRC 501(c) organizations and are regarded as appropriate under FECA for such organizations, should be treated differently from identical expenditures made by political organizations. In other words, the commentators suggested that such expenditures continue to be treated as "exempt function" activities for political organizations (including separate segregated funds of IRC 501(c) organizations) but not for IRC 501(c) organizations.

No final determination of the issue was made; therefore, the treatment of expenditures allowed by FECA is reserved in the final regulations. Reg. 1.527-6(b)(3).

The treatment of indirect expenses also is reserved in the final regulations. Reg. 1.527-6(b)(2). As noted above, indirect expenses are defined in Reg. 1.527-2(c)(2) as expenses, such as overhead and record keeping, that are necessary to support directly related exempt function activities.

The Supplementary Information to the final regulations, T.D. 7744, 1981-1 C.B. 360, explains that when these two subparagraphs (Reg. 1.527-6(b)(2) and (3)) are adopted as a final regulation, they will apply on a prospective basis. This means that an IRC 501(c) organization currently may engage in activities permitted by FECA or may make any indirect exempt function expenditures and will not be subject to tax with respect to such expenditures under IRC 527. This situation may change

when Reg. 1.527-6(b)(2) and (3) are promulgated, but there is no indication at present as to how or when the matters will be resolved. In summary, any decision with regard to the adverse treatment of such expenditures will be applied on a prospective basis from the date of any such decision.

7. Is an IRC 501(c) organization absolutely liable for amounts transferred to an individual or organization that are used for political purposes?

No. While an expenditure may be made for an exempt function directly or through another organization, an IRC 501(c) organization will not be absolutely liable under IRC 527(f)(1) for amounts transferred to an individual or organization. An IRC 501(c) organization is, however, required to take reasonable steps to ensure that the transferee does not use such amounts for an exempt function. Reg. 1.527-6(b)(1)(ii).

C. Separate Segregated Fund Under IRC 527(f)

1. What is the tax treatment to an IRC 501(c) organization of expenditures for political activities made by a separate segregated fund, which is described in IRC 527(f)(3), maintained by the organization?

Expenditures for exempt function activities made by a separate segregated fund de-scribed in IRC 527(f)(3) are considered as made by an orga-nization separate from the IRC 501(c) organization that maintains the fund. IRC 527(f)(3). Thus, an IRC 501(c) organization is not subject to tax under IRC 527 by reason of expenditures for exempt function activities made by a separate segregated fund that it maintains.

2. What is a separate segregated fund?

A separate segregated fund is a fund maintained by an IRC 501(c) organization that is a "separate segregated fund" within the meaning of 2 U.S.C. 441b(b) (formerly 18 U.S.C. 610), or of a

similar state statute, or within the meaning of a state statute that permits the segregation of dues money for expenditure for political campaign activities. IRC 527(f)(3).

3. How is a separate segregated fund taxed?

If a separate segregated fund meets the requirements for a political organization under IRC 527(e)(1), it is treated for tax purposes as a political organization. Reg. 1.527-6(f). Expenditures by the separate segregated fund for non-exempt function activities would have the same result as expenditures made by any other political organization.

If a separate segregated fund does not meet the requirements for a political organization under IRC 527(e)(1), it is subject to tax, as a taxable organization, under general tax principles. See IRC 527(f)(3), which provides that a separate segregated fund "shall be treated as a separate organization."

4. What is the tax treatment of a fund that loses its status as a separate segregated fund under applicable federal or state law?

If a fund loses its status as a separate segregated fund under applicable federal or state law, it is no longer treated as a separate organization for federal tax purposes. IRC 527(f)(3). In that event, expenditures made from such a fund will subject the IRC 501(c) organization that maintains it to tax, pursuant to IRC 527(f)(1).

5. Is a transfer of dues or political contributions by an IRC 501(c) organization to a separate segregated fund considered to be an exempt function expenditure of the IRC 501(c) organization?

A transfer of dues or political contributions by an IRC 501(c) organization to a separate segregated fund is an exempt function expenditure of the IRC 501(c) organization unless the transfer is made promptly after the receipt of such amounts by the IRC 501(c) organization and is made directly to the separate segregated fund. Reg. 1.527-6(e).

Reg. 1.527-6(e) also provides that a transfer is considered promptly and directly made if the following conditions are met:

> (A) The procedures followed satisfy applicable federal or state campaign law and regulations;
>
> (B) The IRC 501(c) organization maintains adequate records to show that amounts transferred were political contributions and dues and not investment income; and
>
> (C) The political contributions and dues were not used to earn investment income for the IRC 501(c) organization.

An IRC 501(c) organization that collected political contributions and dues along with other receipts from its members and deposited all amounts collected in an interest-bearing checking account did not make an exempt function expenditure when it subsequently transferred the political contributions and dues to the separate segregated fund. The IRC 501(c) organization maintained records showing the amount of political contributions and dues received and, once or twice a month, transferred the amounts collected in the immediately preceding month or half-month period to the separate segregated fund. Although the small amount of interest earned on these funds was retained by the IRC 501(c) organization, the funds were deposited in the interest-bearing account primarily as an administrative convenience and not to earn investment income. G.C.M. 39837 (May 22, 1990).

In Alaska Public Service Employees Local 71 v. Commissioner, T.C.M. 1991-650, an IRC 501(c)(5) organization maintained a separate segregated fund. The primary source of funds for the separate segregated fund consisted of contributions from members of the IRC 501(c)(5) organization. Five percent of the general fund dues were allocated to the political fund unless discontinued by the member and some additional contributions were withheld from the salary of the office staff of the IRC 501(c)(5) organization. These amounts were deposited in the general fund and promptly transferred (up to four times a month) to the separate segregated fund. It was agreed that these amounts did not constitute an exempt function expenditure by the IRC 501(c)(5) organization. However, in addition to these amounts, the organization authorized a transfer of $25,000 to the separate segregated fund from its general fund. During that year, the IRC 501(c)(5) organization had more than $25,000 of net investment income. Three years later, after the Service proposed to assess tax under

IRC 527 on the amount transferred, the IRC 501(c)(5) organization attempted to reverse the transaction by transferring $25,000 from the separate segregated fund to the general fund. The court held that since the IRC 501(c)(5) organization failed to show that the transfer consisted of dues and not investment income and that the dues had not been used to earn investment income prior to the transfer, the $25,000 transfer was an exempt function expenditure subject to tax under IRC 527(f)(1). The court further held that the IRC 501(c)(5) organization's attempt to reverse the transaction was not effective.

6. May an IRC 501(c) organization whose income is derived from fees and donations rather than dues establish a separate segregated fund for its political activities or will its investment income be subject to tax under IRC 527?

An IRC 501(c) organization that derives its income from fees and donations is not prohibited from establishing a separate segregated fund. Amounts contributed by others directly to the separate segregated fund and expenditures made by the fund will not be attributed to the IRC 501(c) organization for the purposes of the tax under IRC 527.

The question of whether transfers from the IRC 501(c) organization to the separate segregated fund will be considered exempt function expenditures of the IRC 501(c) organization is determined on the basis of the relevant facts and circumstances. Amounts transferred from the general fund of the IRC 501(c) organization will be considered exempt function expenditures causing the organization to be subject to tax under IRC 527. Amounts collected by the IRC 501(c) organization that are designated for the separate segregated fund and are promptly and directly transferred to the separate segregated fund in accordance with Reg. 1.527-6(e) will not be considered exempt function expenditures of the IRC 501(c) organization.

7. May an IRC 501(c)(4) organization that has a related IRC 501(c)(3) organization also have a related PAC?

There is nothing that prohibits an IRC 501(c)(4) organization that has a related IRC 501(c)(3) organization from also having a related PAC. However, the same concerns apply when an IRC 501(c)(4) organization with a related IRC 501(c)(3) organization conducts political activities through a PAC as when it conducts those activities itself. Like the situation with IRC 501(c)(4) organizations, contributions to a PAC are not tax-deductible. Therefore, to ensure that no tax-deductible contributions are used to support the political campaign activity of the PAC, it must be separately organized and adequate records must be maintained.

As with political activities conducted directly by IRC 501(c)(4) organizations, a particular concern is the allocation of income and expenses when an IRC 501(c)(3) organization and a related PAC share staff, facilities, or other expenses or conduct joint activities. The determination of whether the allocation method used is appropriate and reasonable is based upon the relevant facts and circumstances.

SUBJECT DIRECTORY